FEDERAL RECEIPTS AND COLLECTIONS

17. 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.

Total receipts in 2007 are estimated to be $2,415.9 billion, an increase of $130.4 billion or 5.7 percent relative to 2006. Receipts are projected to grow at an average annual rate of 5.9 percent between 2007 and 2011, rising to $3,034.9 billion. This growth in receipts is largely due to assumed increases in incomes resulting from both real economic growth and inflation.

As a share of GDP, receipts are projected to increase from 17.5 percent in 2006 to 17.6 percent in 2007. The receipts share of GDP is projected to increase to 17.9 percent in 2011.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(in billions of dollars)

	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Individual income taxes	927.2	997.6	1,096.4	1,208.5	1,268.4	1,370.1	1,466.9
Corporation income taxes	278.3	277.1	260.6	268.5	277.1	282.0	292.0
Social insurance and retirement receipts	794.1	841.1	884.1	932.1	980.7	1,037.4	1,096.7
(On-budget)	(216.6)	(231.1)	(241.8)	(253.0)	(264.5)	(278.9)	(295.1)
(Off-budget)	(577.5)	(610.0)	(642.3)	(679.1)	(716.2)	(758.5)	(801.6)
Excise taxes	73.1	73.5	74.6	75.9	77.5	78.9	83.1
Estate and gift taxes	24.8	27.5	23.7	24.4	26.0	20.1	1.6
Customs duties	23.4	25.9	28.1	31.4	31.7	34.0	36.2
Miscellaneous receipts	33.0	42.8	48.4	49.4	52.7	55.7	58.4
Total receipts	2,153.9	2,285.5	2,415.9	2,590.3	2,714.2	2,878.2	3,034.9
(On-budget)	(1,576.4)	(1,675.5)	(1,773.5)	(1,911.1)	(1,998.0)	(2,119.7)	(2,233.3)
(Off-budget)	(577.5)	(610.0)	(642.3)	(679.1)	(716.2)	(758.5)	(801.6)
Total receipts as a percentage of GDP	17.5	17.5	17.6	17.8	17.7	17.9	17.9

Table 17–2. EFFECT ON RECEIPTS OF CHANGES IN THE SOCIAL SECURITY TAXABLE EARNINGS BASE

(In billions of dollars)

	Estimate				
	2007	2008	2009	2010	2011
Social security (OASDI) taxable earnings base increases:					
$94,200 to $98,700 on Jan. 1, 2007	2.3	6.1	6.8	7.6	8.6
$98,700 to $103,500 on Jan. 1, 2008	.....	2.5	6.5	7.3	8.2
$103,500 to $108,600 on Jan. 1, 2009	.....	.....	2.6	7.0	7.8
$108,600 to $114,000 on Jan. 1, 2010	.....	.....	.....	2.8	7.4
$114,000 to $119,400 on Jan. 1, 2011	.....	.....	.....	.....	2.8

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 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	Top of bracket 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 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 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 $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
Small Business Expensing	Deduction increased to $100,000, reduced by amount qualifying property exceeds $400,000, and both amounts inflation-indexed Includes 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 capital gains reduced to 5/15 percent					Tax on capital gains eliminated for taxpayers in 10/15 percent tax brackets	Tax rate on capital gains increased to 10/20 percent		

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003 and 2004 Tax Cuts—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
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					

ENACTED LEGISLATION

Several laws were enacted in 2005 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

ENERGY POLICY ACT OF 2005

This Act, which was signed by President Bush on August 8, 2005, laid the groundwork for a more energy-independent United States. The major provisions of this Act were designed to help secure our energy future and reduce our dependence on foreign sources of energy by encouraging conservation and efficiency, diversifying our energy supply with alternative and renewable sources, expanding domestic energy production in an environmentally sensitive way, and modernizing our electricity infrastructure. The major provisions of this Act affecting receipts are described below.

Energy Infrastructure

Extend and modify tax credit for producing electricity from certain renewable resources.—Taxpayers are allowed a tax credit for electricity produced from wind, biomass, landfill gas and certain other sources. Biomass includes closed-loop biomass (organic material from a plant grown exclusively for use at a qualifying facility to produce electricity) and open-loop biomass (biomass from agricultural livestock waste nutrients or cellulosic waste material derived from forest-related resources, agricultural sources, and other specified sources). Closed-loop biomass may be co-fired with coal, with other biomass, or with both coal and other biomass. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind and closed-loop biomass and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass and landfill gas (both rates are adjusted for inflation since 1992). To qualify for the credit under prior law, the electricity had to be produced at a facility placed in service before January 1, 2006 unless it was a refined coal facility, for which the placed-in-service date was extended three years, through December 31, 2008. This Act extended the placed-in-service date by two years, through December 31, 2007, for electricity produced from all qualifying facilities, except those producing electricity from solar energy and refined coal. For facilities producing electricity from solar energy and refined coal, the placed-in-service termination dates of prior law were not changed.

This Act expanded the energy production credit to apply to electricity produced from hydropower at a facility: (1) that produced hydroelectric power before August 8, 2005 and to which efficiency improvements or additions to capacity are made after August 8, 2005 and before January 1, 2008; or (2) that did not produce hydroelectric power before August 8, 2005 and to which turbines or other electricity generating equipment is added after August 8, 2005 and before January 1, 2008. This Act also expanded the credit to apply to sales of coal produced from coal reserves that on June 14, 2005 were: (1) owned by a tribe of Indians recognized by the United States; or (2) were held in trust for a tribe of Indians or its members by the United States. The credit for Indian coal is $1.50 per ton for coal sold after December 31, 2005 and before January 1, 2010, and $2.00 per ton for coal sold after December 31, 2009 and before January 1, 2013 (both rates are adjusted for inflation).

Under prior law, cooperatives were not allowed to pass any portion of the energy production credit through to their patrons. Under this Act, eligible cooperatives may elect to pass any portion of the credit through to their patrons.

Provide tax credits for investment in clean coal facilities.—Under this Act, a 20-percent tax credit was provided for qualified investments in electricity production facilities using integrated gasification combined cycle (IGCC) technologies and a 15-percent credit was

provided to qualified investments in electricity production facilities using other advanced coal-based technologies. Qualified projects must be economically feasible and use the appropriate clean coal technologies. The Secretary of Treasury, in consultation with the Secretary of Energy, may allocate $800 million of credits to IGCC projects and $500 million of credits to projects using other advanced coal-based technologies. A 20-percent tax credit was also provided for investment in certified gasification projects. The total amount of gasification credits allocable by the Secretary of the Treasury is $350 million. These three credits are effective for qualified investments made after August 8, 2005.

Modify treatment of nuclear decommissioning funds.—Under prior law, deductible contributions to nuclear decommissioning funds were limited to the amount included in the taxpayer's cost of service to ratepayers. In addition, deductible contributions were not permitted to exceed the amount the Internal Revenue Service (IRS) determined to be necessary to provide for level funding of an amount equal to the taxpayer's post-1983 decommissioning costs. Effective for taxable years beginning after December 31, 2005, this Act repealed the cost-of-service requirement for deductible contributions to a nuclear decommissioning fund and expanded the deduction to apply to pre-1984 decommissioning costs. As provided under prior law, deductible contributions may not be made more rapidly than required to provide for level funding of the taxpayer's decommissioning costs.

Reduce recovery period for certain assets used in the transmission of electricity.—Under the Modified Accelerated Cost Recovery System (MACRS) of current law, assets used in the transmission and distribution of electricity for sale may be depreciated over 20 years. This Act reduced the recovery period for certain assets used in the transmission of electricity for sale to 15 years. To qualify for the reduced recovery period: (1) the original use of the property must commence with the taxpayer after April 11, 2005; (2) the property must be used in the transmission at 69 or more kilovolts of electricity for sale; and (3) the property must not be subject to a binding contract on or before April 11, 2005 or, if self-constructed, the taxpayer or a related party must not have started construction on or before such date.

Provide 84-month amortization for certain air pollution control facilities.—A taxpayer may elect to recover a portion of the cost of a certified pollution control facility over a period of 60 months under current law. To be eligible, the pollution control facility must be new, used in connection with a plant in operation before January 1, 1976, certified as being in conformity with State and Federal environmental laws, and meet certain other requirements. The amortizable portion is 100 percent if the facility has a depreciation recovery period of 15 years or less; otherwise, the portion equals 15 divided by the recovery period. This Act provided 84-month amortization to a similar portion of the cost of certified air pollution control facilities used in connection with an electric generation plant that is primarily coal fired and that was not in operation before January 1, 1976. For an air pollution control facility to be eligible for cost recovery over a period of 84 months: (1) its construction, reconstruction, or erection must be completed after April 11, 2005; or (2) it must be acquired after April 11, 2005 and its original use must commence with the taxpayer after that date.

Domestic Fossil Fuel Security

Allow expensing of equipment used in the refining of liquid fuels.—This Act allowed a taxpayer to elect to treat 50 percent of the cost of qualified refinery investments as a current expense. An eligible investment must be placed in service after August 8, 2005 and before January 1, 2012, and cannot be subject to a written binding construction contract in effect on or before June 14, 2005. If self-constructed, construction must begin after June 14, 2005 and before January 1, 2008; otherwise, a written binding contract for construction must be entered into before January 1, 2008, or the property must be placed in service before that date. The original use of the property must commence with the taxpayer, and the property must meet all applicable environmental laws. If part of an existing refinery, the investment must increase refining capacity by at least five percent or increase the throughput of qualified fuels by at least 25 percent. Qualified fuels include oil produced from shale and tar sands. As a condition of eligibility, refineries of liquid fuels must report to the IRS on refinery operations.

Reduce recovery period for certain natural gas distribution lines.—Under MACRS, natural gas distribution lines are assigned a 20-year recovery period. This Act established a 15-year recovery period for natural gas distribution lines, the original use of which begins with the taxpayer after April 11, 2005 and before January 1, 2011. The shortened recovery period does not apply to property subject to a binding contract on or before April 11, 2005, or, if self-constructed, the taxpayer or a related party must not have started construction on or before such date.

Treat natural gas gathering lines as seven-year property.—This Act clarified existing law by establishing a statutory seven-year recovery period for natural gas gathering lines, the original use of which commences with the taxpayer after April 11, 2005. In addition, no depreciation adjustment must be made with respect to this property in computing a taxpayer's alternative minimum taxable income.

Provide two-year amortization for certain geological and geophysical expenditures.—Geological and geophysical expenditures (G&G costs) are costs incurred by a taxpayer for the purpose of obtaining and accumulating data that will serve as the basis for the

acquisition and retention of mineral properties by taxpayers exploring for minerals. A key issue with regard to such costs has been whether or not they are capital in nature. Various courts have held that G&G costs are capital and allocable to the cost of the property acquired or retained; IRS administrative rulings have provided further guidance regarding the definition and proper tax treatment of such costs. Under this Act, G&G costs paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, may be amortized over two years.

Conservation and Energy Efficiency

Provide personal tax credit for certain solar energy equipment.—This Act provided a new nonrefundable tax credit for individuals who purchase qualified 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. Expenditures that are properly allocable to a swimming pool or hot tub do not qualify for the credit. The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, is equal to 30-percent of the cost of the equipment and its installation, with a maximum credit of $2,000 for each system. A 30-percent credit for the cost of qualified fuel cell power plants, not to exceed $500 for each 0.5 kilowatt of capacity, was also provided.

Provide tax credit for energy-efficient improvements to principal residences.—This Act provided a nonrefundable 10-percent tax credit to homeowners for the cost of purchasing qualified energy efficient improvements installed in or on a dwelling unit in the United States that is used as their principal residence. Qualified energy efficient improvements include any energy efficiency building envelope component that meets or exceeds the prescriptive criteria for such a component established by the 2000 International Energy Conservation Code as supplemented and in effect on August 8, 2005. Building envelope components are: (1) insulation materials or systems that are specifically and primarily designed to reduce the heat loss or gain for a dwelling; (2) exterior windows (including skylights) and doors; and (3) metal roofs with appropriate pigmented coating specifically and primarily designed to reduce the heat gain for a dwelling. The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, may not exceed $500 over all taxable years, and no more than $200 of such credit may be attributable to expenditures on windows.

This Act also provided a tax credit to homeowners for the cost of residential energy property installed in or on a dwelling unit in the United States that is used as their principal residence. Residential energy property includes: (1) advanced main air circulating fans; (2) qualified natural gas, propane, or oil furnaces and hot water boilers; and (3) energy-efficient building property (certain electric and geothermal heat pumps, air conditioners, and natural gas, propane, or oil water heaters). The credit, which applies to property placed in service after December 31, 2005 and before January 1, 2008, may not exceed $50 per fan, $150 for each furnace or boiler, and $300 for each item of energy-efficient building property.

Provide tax credit for the purchase of qualified hybrid, fuel cell and alternative fuel motor vehicles.—A qualified fuel cell vehicle is propelled by power derived from one or more cells that convert chemical energy directly into electricity. This Act provided a credit for the purchase of fuel cell vehicles, effective for vehicles placed in service after December 31, 2005 and before January 1, 2015. The amount of the credit is equal to a base credit amount, determined by the weight class of the vehicle and, in the case of automobiles and light trucks, an additional credit amount, determined by the rated fuel economy of the vehicle compared to the 2002 model year city fuel economy rating for vehicles of various weight classes. The base credit amount ranges from $8,000 ($4,000 after December 31, 2009) for vehicles with a gross weight less than or equal to 8,500 pounds, to $40,000 for vehicles weighting over 26,000 pounds. The additional credit amount ranges from $1,000 for a fuel economy rating that is at least 150 percent, but less than 175 percent of the 2002 model year city fuel economy rating, to $4,000 for a fuel economy rating that is at least 300 percent of the 2002 model year city fuel economy rating.

A qualified alternative fuel motor vehicle operates only on qualifying alternative fuels (compressed natural gas, liquefied natural gas, liquefied petroleum gas, hydrogen and any liquid fuel that is at least 85 percent methanol) and is incapable of operating on gasoline or diesel fuel (except to the extent that gasoline or diesel fuel is part of a qualified mixed fuel). This Act provided a credit for the purchase of alternative fuel vehicles, effective for vehicles placed in service after December 31, 2005 and before January 1, 2011. The credit is equal to 50 percent of the incremental cost of the vehicle (the excess of the manufacturer's suggested retail price over the manufacturer's suggested retail price for a comparable gasoline or diesel vehicle), plus an additional 30 percent if the vehicle meets certain emissions standards. Depending on the weight of the vehicle, a maximum allowable incremental cost is specified, ranging from $5,000 for a vehicle weighing less than or equal to 8,500 pounds, to $40,000 for a vehicle weighing more than 26,000 pounds. The total credit for the purchase of a new alternative fuel vehicle may not exceed $4,000 for a vehicle weighing less than or equal to 8,500 pounds and $32,000 for a vehicle weighing more than 26,000 pounds. Certain mixed fuel vehicles (vehicles that use a combination of an alternative fuel and a petroleum-based fuel) are eligible for a reduced credit. Specifically, if the vehicle operates on a mixed fuel that is at least 75 percent alternative fuel, the vehicle is eligible for 70 percent of the other-

wise allowable alternative fuel vehicle credit and if the vehicle operates on a mixed fuel that is at least 90 percent alternative fuel, the vehicle is eligible for 90 percent of the otherwise allowable credit.

A qualified hybrid vehicle is a motor vehicle that draws propulsion energy from on-board sources of stored energy that include both an internal combustion engine or heat engine using combustible fuel and a rechargeable energy storage system. This Act provided a credit for the purchase of qualified hybrid motor vehicles placed in service after December 31 2005 and before January 1, 2011 (January 1, 2010 in the case of a qualified hybrid vehicle weighing more than 8,500 pounds). For a qualified hybrid automobile or light truck weighing less than or equal to 8,500 pounds, or a lean-burn technology motor vehicle, the credit consists of two components: (1) a fuel economy credit of $400 to $2,400, depending upon the rated fuel economy of the vehicle compared to the 2002 model year standard; and (2) a conservation credit of $250 to $1,000, depending upon the estimated lifetime fuel savings of the vehicle compared to a comparable 2002 model year vehicle. For a qualified hybrid vehicle weighing more than 8,500 pounds (a medium or heavy truck), the amount of credit is determined by the estimated increase in fuel economy and the incremental cost of the hybrid vehicle compared to a vehicle comparable in weight, size and use that is powered solely by a gasoline or diesel internal combustion engine. Depending on the weight of the vehicle, a maximum incremental cost is specified, ranging from $7,500 for a vehicle weighing more than 8,500 pounds but less than or equal to 14,000 pounds, to $30,000 for a vehicle weighing more than 26,000 pounds. For a vehicle that achieves a fuel economy increase of at least 30 percent but less than 40 percent, the credit is equal to 20 percent of the incremental cost of the vehicle. The credit increases to 30 percent of the incremental cost for a vehicle that achieves a fuel economy increase of at least 40 percent but less than 50 percent, and to 40 percent of the incremental cost for a vehicle that achieves a fuel economy increase of 50 percent or more. In the case of passenger automobiles and light trucks, a limitation is imposed on the number of qualified hybrid motor vehicles and advanced lean-burn technology motor vehicles sold by each manufacturer. Taxpayers may claim the full amount of the allowable credit up to the end of the first calendar quarter following the quarter in which the manufacturer from whom they purchased their vehicle records its 60,000th sale of a hybrid or advanced lean-burn technology passenger automobile or light truck. The credit declines to one half the otherwise allowable amount in the subsequent two quarters, to one quarter of the otherwise allowable amount in the next two quarters, and then expires.

Provide additional incentives to promote energy conservation and efficiency.—This Act provided a number of additional incentives to promote energy conservation and efficiency, which included: (1) a tax deduction for energy-efficient property installed during the construction of a commercial building; (2) tax credits for the purchase of qualified fuel cell and stationary micro-turbine power plants; (3) a tax credit for the construction of qualified new energy-efficient homes; and (4) a tax credit for the production of certain energy-efficient dishwashers, clothes washers and refrigerators.

Offsets

Reinstate excise taxes deposited in the Oil Spill Liability Trust Fund.—Between December 31, 1989 and January 1, 1995, a five-cent-per-barrel tax was imposed on: (1) crude oil received at a U.S. refinery; (2) imported petroleum products received for consumption, use or warehousing; and (3) any domestically produced crude oil that was exported from the United States if, before exportation, no taxes were imposed on the crude oil. Collections of the tax, which were deposited in the Oil Spill Liability Trust Fund, were used for several purposes, including the payment of costs associated with responding to and removing oil spills. The tax was imposed only if the unobligated balance in the Oil Spill Liability Trust Fund was less than $1 billion. This Act reinstated this tax, effective April 1, 2006 through December 31, 2014. The tax will be suspended during a calendar quarter if, at the close of the preceding quarter, the unobligated balance in the Fund exceeds $2.7 billion.

Extend excise taxes deposited in the Leaking Underground Storage Tank (LUST) Trust Fund.—An excise tax is imposed, generally at a rate of 0.1 cents per gallon, on gasoline and other liquid motor fuels used on highways, in aviation, on inland waterways, and in diesel-powered trains. The tax, which is deposited in the LUST Trust Fund, was scheduled to expire on October 1, 2005 under prior law. This Act extended the tax through September 30, 2011. In addition, the tax was expanded to apply to dyed fuel, which was exempt from the tax under prior law and all other liquid fuel that is not exported.

Modify recapture of section 197 amortization.—Gain on the sale of depreciable property must be recaptured as ordinary income to the extent of depreciation deductions previously claimed. The recapture amount is computed separately for each item of property that is sold. This Act modified the recapture rules of current law with respect to dispositions of section 197 intangibles. Section 197 intangibles include goodwill; a patent, copyright, formula, design or similar item; any license, permit, or other right granted by a governmental unit or agency; and any franchise, trademark, or trade name. Under this Act, multiple section 197 intangibles sold in a single transaction or in a series of transactions after August 8, 2005 are treated as a single asset for the purpose of calculating the amount of gain to be recaptured as ordinary income. This rule does not apply to any amortizable section 197 intangible for which adjusted basis exceeds fair market value.

SAFE, ACCOUNTABLE, FLEXIBLE, EFFICIENT TRANSPORTATION EQUITY ACT: A LEGACY FOR USERS

This Act, which was signed by President Bush on August 10, 2005, reauthorized Federal spending for surface transportation programs through 2009, extended Federal highway taxes through 2011, and made numerous changes to transportation laws affecting safety, the environment, and other matters. The major provisions of this Act affecting receipts are described below.

Trust Fund Reauthorization

Extend excise taxes deposited in the Highway Trust Fund.—Excise taxes imposed on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, and tires for heavy highway vehicles generally are deposited in the Highway Trust Fund. Taxes deposited in the Highway Trust Fund are imposed on nonaviation gasoline at a rate of 18.3 cents per gallon, on diesel fuel and kerosene at a rate of 24.3 cents per gallon, and on special motor fuels at varying rates. Under prior law, these tax rates were scheduled to fall to 4.3 cents per gallon (or comparable rates in the case of special motor fuels) on October 1, 2005. A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles (generally, trucks with a gross weight greater than 33,000 pounds, trailers with a gross weight greater than 26,000 pounds, and highway tractors). In addition, a heavy highway vehicle use tax of up to $550 per year is imposed on highway vehicles with a gross weight of at least 55,000 pounds. A tax is also imposed on tires with a rated load capacity exceeding 3,500 pounds, generally at a rate of 0.945 cent per pound of excess. Under prior law, the taxes on heavy highway vehicles and tires for heavy highway vehicles were scheduled to expire on September 30, 2005; the heavy vehicle use tax was scheduled to expire on September 30, 2006. This Act extended the taxes on nonaviation gasoline, diesel fuel, kerosene, special motor fuels, heavy highway vehicles, tires for heavy highway vehicles, and the use of heavy highway vehicles at their prior law rates through September 30, 2011.

Eliminate Aquatic Resources Trust Fund and create Sport Fish Restoration and Boating Trust Fund.—Under prior law, 13.5 cents per gallon of the excise taxes imposed on motorboat gasoline and special motor fuels, and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment, was transferred from the Highway Trust Fund to the Land and Water Conservation Fund and to the Boat Safety and Sport Fish Restoration Accounts of the Aquatic Resources Trust Fund. The remaining 4.8 cents per gallon of these taxes was retained in the General Fund of the Treasury. Amounts transferred from the Highway Trust Fund to the Land and Water Conservation Fund and the Aquatic Resources Trust Fund were allocated as follows: (1) Up to $70 million in annual collections was transferred to the Boat Safety Account, subject to an overall limit equal to the amount that would not cause the Boat Safety Account to have an unobligated balance in excess of $70 million. (2) The next $1 million in annual collections was transferred to the Land and Water Conservation Fund. (3) All remaining annual collections were transferred to the Sport Fish Restoration Account. As explained in the preceding discussion of the Highway Trust Fund, these excise taxes were scheduled to decline to 4.3 cents per gallon on September 30, 2005; in addition, the retention of 4.8 cents per gallon of these taxes in the General Fund of the Treasury was scheduled to expire on that date.

Effective October 1, 2005, this Act eliminated the Aquatic Resources Trust Fund and created the Sport Fish Restoration and Boating Trust Fund. This Act also extended the taxes on motorboat fuels and on gasoline used as a fuel in the nonbusiness use of small-engine outdoor power equipment at their prior law rates through September 30, 2011, but did not extend the retention of 4.8 cents per gallon of these taxes in the General Fund of the Treasury. Therefore, effective October 1, 2005, 18.3 cents per gallon of the taxes on these fuels is deposited in the Highway Trust Fund and then transferred to the Land and Water Conservation Fund and to the Sport Fish Restoration and Boating Trust Fund as follows: (1) The first $1 million in annual collections is transferred to the Land and Water Conservation Fund. (2) All remaining annual collections are transferred to the Sport Fish Restoration and Boating Trust Fund.

Excise Tax Simplification and Reform

Modify excise taxes on the retail sale of certain automobiles, heavy trucks and trailers.—An excise tax is imposed on the sale of automobiles weighing less than or equal to 6,000 pounds with a fuel economy less than or equal to 22.5 miles per gallon. The tax ranges from $1,000 to $7,700, depending on the fuel economy of the automobile. Under prior law, the tax applied to all limousines, regardless of their weight. Effective for sales after September 30, 2005, this Act repealed the tax with respect to limousines weighing more than 6,000 pounds.

A tax equal to 12 percent of the sales price is imposed on the first retail sale of heavy highway vehicles. Under prior law, the tax was imposed on trucks with a gross weight greater than 33,000 pounds; trailers with a gross weight greater than 26,000 pounds; and highway tractors, regardless of weight. Effective for sales after September 30, 2005, this Act repealed the tax with respect to tractors weighing less than or equal to 19,500 pounds, provided that when combined with a towed vehicle, the total weight does not exceed 33,000 pounds.

Modify taxation of alternative fuels.—In general, nonaviation gasoline is taxed at 18.3 cents per gallon, aviation gasoline is taxed at 19.3 cents per gallon, and diesel fuel and kerosene are taxed at 24.3 cents per gallon. Although most special motor fuels are subject

to tax at 18.3 cents per gallon, certain special motor fuels and compressed natural gas are taxed at reduced rates. Effective for sales after September 30, 2006, this Act increased the tax on certain special motor fuels as follows: (1) Liquefied petroleum gas and P Series fuels (as defined by the Secretary of Energy) will be taxed at 18.3 cents per gallon. (2) Compressed natural gas will be taxed at 18.3 cents per energy equivalent of a gallon of gasoline. (3) Liquefied natural gas, any liquid fuel derived from coal (other than ethanol or methanol) and liquid hydrocarbons derived from biomass will be taxed at 24.3 cents per gallon. This Act also created two new excise tax credits—the alternative fuel credit and the alternative fuel mixture credit—for the sale or use of alternative fuels. For purposes of the credits, alternative fuels are defined as liquefied petroleum gas, P Series fuels (as defined by the Secretary of Energy), compressed or liquefied natural gas, liquefied hydrogen, liquid fuel derived from coal through the Fisher-Tropsch process, and liquid hydrocarbons derived from biomass. The alternative fuel credit is 50 cents for each gallon of alternative fuel or gasoline-gallon equivalent of nonliquid alternative fuel sold by the taxpayer for use as a motor fuel in a motor vehicle or motorboat. The alternative fuel mixture credit is 50 cents for each gallon of alternative fuel used in producing an alternative fuel mixture for sale or use in a trade or business of the taxpayer. These credits, which are effective for qualified fuels sold or used after October 1, 2006 and before October 1, 2009 (October 1, 2014 for liquefied hydrogen), are to be paid from the General Fund of the Treasury.

Cap excise tax on certain fishing equipment.—Effective for sales after September 30, 2005, the 10-percent excise tax imposed on the sale of fishing rods and poles is capped at $10.00 on each rod and pole sold.

Modify aviation excise taxes.—Fuel used on a farm for farming purposes is exempt from Federal excise taxes on fuel. Under prior law, crop-dusters, instead of farm owners and operators, were allowed to claim a refund for taxes on aviation fuel consumed while operating over a farm if they had written consent from the farm owner or operator. Fuel consumed traveling to and from the farm was not exempt from Federal excise taxes on fuel. This Act repealed the requirement that crop-dusters receive written consent to apply for a refund and clarified that travel to and from a farm is exempt use, effective for fuel used after September 30, 2005.

Domestic passenger tickets are subject to an air passenger ticket tax equal to 7.5 percent of the ticket price, plus $3.20 per domestic flight segment. Amounts paid to persons engaged in the business of transporting property by air for hire are subject to an air cargo tax of 6.25 percent. The air passenger ticket tax does not apply to: (1) transportation by helicopter if the helicopter does not use Federally funded airport and airway services and is used for certain timber operations or the exploration, development or removal of oil, gas, or hard minerals; and (2) helicopters and fixed-wing aircraft that provide emergency medical services. In addition, the $3.20 tax on flight segments does not apply to a domestic segment beginning or ending at a rural airport. Neither the air passenger ticket tax nor the air cargo tax apply to transportation by an aircraft having a maximum certificated takeoff weight of 6,000 pounds or less unless the aircraft is operated on an established line. Under prior law, a rural airport was defined as an airport that: (1) had fewer than 100,000 passengers departing by air during the second preceding calendar year and was located more than 75 miles from a larger airport; or (2) was receiving essential air service subsidy payments as of August 5, 1997. This Act expanded the definition of a rural airport, effective October 1, 2005, to include airports not connected by paved roads to another airport and having fewer than 100,000 passengers departing on flight segments of at least 100 miles during the second preceding calendar year. This Act also expanded the types of transportation exempt from the passenger ticket and/or air cargo tax, effective with respect to transportation beginning after September 30, 2005. The expansions included the following: (1) The exemption of transportation by a seaplane from the air passenger ticket tax and the air cargo tax, provided the take off is from, and the landing is on, water, and the places from which such landings and takeoffs occur have not received or are not receiving financial assistance from the Airport and Airway Trust Fund. (2) The exemption of fixed-wing aircraft engaged in timber operations from aviation excise taxes if they are not using Federally-funded airport and airway services. (3) The exemption of sightseeing flights from the passenger ticket tax.

Modify alcohol-related excise taxes.—The 2004 job creation act suspended the special occupational taxes imposed on producers and others engaged in the marketing of distilled spirits, wine, and beer, for the period July 1, 2005 through June 30, 2008. This Act repealed these taxes effective July 1, 2008. This Act also: (1) provided an income tax credit to eligible wholesalers, distillers, and importers of distilled spirits for the cost of carrying tax-paid products in inventory, effective for taxable years beginning after September 30, 2005; and (2) allowed certain domestic producers and importers of distilled spirits, wine, and beer with annual excise tax liability of $50,000 or less attributable to these articles in the preceding calendar year to file returns and pay taxes quarterly (rather than semi-monthly) in most cases effective for quarterly periods beginning after December 31, 2005.

Provide custom gunsmiths an exemption from taxes on firearms and ammunition.—Sales of firearms and ammunition by the manufacturer, producer or importer generally are subject to an excise tax of 10 or 11 percent of the retail price, depending upon the type of good sold. Sales of machine guns and short-barreled firearms are exempt from the tax. This Act

expanded the exemption to apply to sales of firearms, pistols, and revolvers by a person who manufactures, produces, or imports less than 50 of such articles during the calendar year. The exemption is effective for sales after September 30, 2005.

Other Provisions

Provide tax-exempt financing for highway projects and rail-truck transfer facilities.—This Act authorized $15 billion of tax-exempt bond authority to finance qualified highway or surface freight transfer facilities.

Modify treatment of kerosene for use in aviation.—In general, aviation-grade kerosene is taxed at a rate of 21.8 cents per gallon when it enters the United States, is removed from a refinery or terminal, or is sold to an unregistered person, unless there was a prior taxation upon entry or removal of the fuel. Aviation-grade kerosene may be taxed at a reduced rate, either 4.3 or zero cents per gallon, if it is removed directly into the fuel tank of an aircraft for use in commercial aviation or is for a use that is exempt from tax. Kerosene used for surface transportation is taxed at the diesel fuel rate of 24.3 cents per gallon. Under this Act, all kerosene is taxed at a rate of 24.3 cents per gallon unless it is removed directly into the fuel tank of an aircraft or is for a use that is exempt from tax. This change is effective for kerosene that enters the United States, is removed from a refinery or terminal, or is sold after September 30, 2005. If the kerosene taxed at 24.3 cents per gallon is used for aviation or tax exempt purposes, a credit or refund may be claimed.

Combat fuel fraud.—This Act included a number of provisions designed to combat fuel fraud. Under this Act: (1) Farmers who purchase clear diesel fuel must pay the excise tax on that fuel and then claim a refund for taxes paid on fuel used for farming purposes. (2) Credit card companies that allow tax-exempt fuel purchases on their cards must register with the IRS and be the party responsible for claiming refunds of the tax. (3) Blenders, importers, pipeline operators, position holders, refiners, terminal operators, and vessel operators who are registered with the IRS must reregister in the event of a change in ownership. (4) Information regarding taxable fuels destined for the United States must be transmitted electronically from the Bureau of Customs and Border Control to the IRS. (5) Operators of deep-draft ocean-going vessels used in the bulk transfer of fuel must register with the IRS.

KATRINA EMERGENCY TAX RELIEF ACT OF 2005

This Act, which was signed by President Bush on September 23, 2005, provided emergency tax relief for individuals and employers affected by Hurricane Katrina and incentives for charitable giving. For purposes of this Act, the "Hurricane Katrina disaster area" is the area with respect to which a major disaster was declared by President Bush before September 14, 2005 by reason of Hurricane Katrina and the term "core disaster area" means that portion of the Hurricane Katrina disaster area determined by the President to warrant individual or individual and public assistance. The major provisions of this Act are described below.

Tax Relief for Victims of Hurricane Katrina

Suspend certain limitations on personal casualty losses.—Under current law, a taxpayer generally is allowed to claim a deduction for any uncompensated loss of nonbusiness property arising from theft or casualty (e.g., fire, storm). Personal theft and casualty losses are deductible only if they exceed $100 per casualty or theft. In addition, aggregate net losses from casualty or theft are deductible only to the extent that they exceed 10 percent of the taxpayer's adjusted gross income (AGI). Effective for personal casualty and theft losses occurring in the Hurricane Katrina disaster area on or after August 25, 2005 and attributable to the hurricane, this Act suspended both the $100 and 10-percent-of-AGI limitations otherwise applicable under current law. In addition, losses under this provision are disregarded when applying the 10-percent-of-AGI threshold to other personal casualty or theft losses.

Extend replacement period for non-recognition of gain.—Gain realized by a taxpayer on the involuntary conversion of property generally is deferred to the extent the taxpayer purchases property similar or related in service or use to the converted property within the replacement period. The replacement period generally begins with the date of the disposition of the converted property and ends two years after the close of the first taxable year in which any part of the gain upon conversion is realized. Under current law, special rules extend the replacement period for certain real property and principal residences damaged by a Presidentially declared disaster or the terrorist attacks on September 11, 2001, and for livestock sold as the result of drought, flood, or other weather-related conditions. This Act extended from two to five years the replacement period for property in the Hurricane Katrina disaster area compulsorily or involuntarily converted on or after August 25, 2005, as a result of the hurricane.

Provide exclusion for certain cancellations of indebtedness.—Under current law, gross income generally includes any income realized by a debtor from the discharge of indebtedness, subject to certain exceptions for debtors in Title 11 bankruptcy cases, insolvent debtors, certain farm indebtedness, and certain real property business indebtedness. This Act excluded from gross income the discharge of nonbusiness debt on or after August 28, 2005 and before January 1, 2007, if the debtor's principal place of abode on August 25, 2005 was located in: (1) the core disaster area, or (2) the Hurricane Katrina disaster area and such person suffered economic loss as a result of the hurricane.

Provide special rule for purposes of computing the child tax credit and earned income tax credit.—The earned income tax credit (EITC) is a refundable credit for low-income workers, the amount of which depends on the earned income of the taxpayer and whether the taxpayer has one, more than one, or no qualifying children. Taxpayers with income below certain thresholds also are eligible for a child credit for each qualifying child, which may be refundable. Under this Act, qualified individuals were permitted to elect to use their earned income from the prior taxable year to determine eligibility for these credits for the taxable year that includes August 25, 2005 if their earned income for the taxable year that includes August 25, 2005 was less than their earned income for the preceding taxable year. Qualified individuals are those whose principal place of abode on August 25, 2005 was located in: (1) the core disaster area, or (2) in the Hurricane Katrina disaster area and who were displaced by the hurricane.

Provide special rules for mortgage revenue bonds.—Under current law State and local governments may issue mortgage revenue bonds (MRBs) to provide low-interest rate financing to qualified individuals for the purchase, improvement, or rehabilitation of owner-occupied residences. Several restrictions, including purchase price limitations, mortgagor income, and the first-time homebuyer requirement (except with regard to residences in certain targeted areas) apply to the financing of mortgages with MRBs. Effective for financing provided before January 1, 2008, this Act waived the first-time homebuyer requirement of current law with respect to financing for: (1) residences located in the core disaster area, and (2) any other residence if the mortgagor owned a principal residence in the Hurricane Katrina disaster area on August 28, 2005 that was rendered uninhabitable by the hurricane and the residence being financed is located in the same State as the prior principal residence. This Act also increased the current law limitation on home improvement loans financed with MRBs from $15,000 to $150,000 for residences located in the Hurricane Katrina disaster area, to the extent the loan is for the repair of damage caused by the hurricane.

Extend tax filing and payment deadlines.—Deadlines for the filing of tax returns and the payment of taxes, including employment and excise taxes, otherwise required on or after August 25, 2005, were extended until February 28, 2006 for taxpayers affected by Hurricane Katrina.

Authorize the Secretary of the Treasury to make adjustment regarding taxpayer and dependency status.—This Act authorized the Secretary of the Treasury to make adjustments in applying the Federal tax laws that may be necessary to ensure that taxpayers do not lose any deduction or credit or experience a change of filing status because of temporary relocations caused by Hurricane Katrina. This provision applies to taxable years beginning in 2005 and 2006.

Tax Relief for Employers

Expand eligibility for the work opportunity tax credit.—Under current law, the work opportunity tax credit is available for first-year wages paid to a qualified individual from one or more of eight targeted groups who begins work before January 1, 2006. This Act expanded eligibility for the credit to include wages paid to: (1) an individual who on August 28, 2005 had a principal place of abode in the core disaster area and is hired during the two-year period beginning on such date for a position, the principal place of employment of which is located in the core disaster area; and (2) an individual who on August 28, 2005 had a principal place of abode in the core disaster area, was displaced from such abode by reason of Hurricane Katrina, and is hired during the period beginning on such date and ending on December 31, 2005, without regard to whether the new principal place of employment is in the core disaster area.

Provide an employee retention credit to employers affected by Hurricane Katrina.—Under this Act, a 40-percent tax credit was provided to eligible employers for the first $6,000 in qualified wages paid to an eligible employee. To be eligible, an employer must have employed an average of 200 or fewer employees in a business located in the core disaster area on August 28, 2005 that was inoperable on any day beginning on that date and ending on December 31, 2005, as a result of damage caused by the hurricane. An eligible employee, with respect to an eligible employer, is one whose principal place of employment with that employer was in the core disaster zone on August 28, 2005. Qualified wages are those paid by an eligible employer to an eligible employee on any day after August 28, 2005 and before January 1, 2006 during the period beginning on the date on which the trade or business first became inoperable at the principal place of employment of the employee and ending on the date on which such trade or business resumed significant operations at such principal place of employment. Qualified wages include those paid without regard to whether the employee performs a service, performs services at a different place of employment than such principal place of employment, or performs services at such principal place of employment before significant operations have resumed.

Incentives for Charitable Giving

Suspend limitations on charitable contributions.—Deductions for charitable contributions are subject to certain limitations under current law, depending on the type of taxpayer, the property being contributed, and the donee organization. This Act suspended the current law percentage limitations for individuals who itemize deductions and corporations with respect to cash contributions to certain public charities made after

August 27, 2005 and before January 1, 2006; however, for corporations, the suspension applied only to contributions for relief efforts related to Hurricane Katrina.

Provide an exemption to taxpayers who housed individuals displaced by Hurricane Katrina.—Taxpayers who provided housing to individuals displaced by Hurricane Katrina were provided a one-time $500 exemption for each individual whom they housed. Taxpayers may claim the exemption for up to four displaced individuals, for a maximum exemption amount of $2,000. An individual displaced by Hurricane Katrina is a person (other than a spouse or dependent of the taxpayer): (1) whose principal place of abode on August 28, 2005 was in the Hurricane Katrina disaster area, (2) who is displaced from such abode, and (3) who is provided housing free of charge in the taxpayer's principal residence for a period of 60 consecutive days, which ends in the taxable year in which the exemption is claimed. For individuals whose principal place of abode on August 28, 2005 was in the Hurricane Katrina disaster area but outside the core disaster area, in order to qualify as a displaced individual, their abode must have been damaged by the hurricane or they must have been evacuated as a result of the hurricane. This provision applies to taxable years beginning in 2005 and 2006.

Increase deduction for the costs associated with the charitable use of a motor vehicle.—Taxpayers may claim a deduction for the costs associated with the use of a motor vehicle in providing donated services to charity. The deduction may be calculated by using a standard mileage rate of 14 cents per mile. This Act increased the charitable standard mileage rate to 34 cents per mile for the costs associated with the use of a vehicle in providing services to charity solely for the provision of relief related to Hurricane Katrina. In addition, this Act excluded from the gross income of a volunteer up to 48.5 cents per mile in reimbursements paid by a charitable organization to the volunteer for the costs associated with using a passenger automobile in performing such charitable work. A volunteer may not claim a deduction or credit with respect to reimbursed amounts. Certain recordkeeping requirements apply. These changes apply to such relief provided during the period beginning on August 25, 2005 and ending on December 31, 2006.

Expand enhanced deduction for contributions of food and books.—A taxpayer's deduction for charitable contributions of inventory generally is limited to the taxpayer's basis in the inventory, or, if less, the fair market value of the inventory. However, an enhanced deduction is provided to C corporations for certain contributions of inventory. This Act expanded the enhanced deduction to apply to qualified contributions of: (1) food inventory by all taxpayers (not just C corporations) engaged in a trade or business, and to (2) books to public schools by C corporations. The donated food must meet certain quality and labeling standards, and the taxpayer's total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The donated books must be suitable for use and used by the public school in its educational programs. The enhanced deduction applies to such qualified contributions of food and books made after August 27, 2005 and before January 1, 2006.

Special Rules for the Use of Retirement Funds

Allow tax-favored and penalty-free withdrawals from retirement plans for relief related to Hurricane Katrina.—Under current law, a distribution from a qualified retirement plan, a tax-sheltered annuity (a 403(b) annuity), an eligible deferred compensation plan maintained by a State or local government (a governmental 457 plan), or an individual retirement arrangement (IRA) generally is included in the taxpayer's gross income in the year of distribution. In addition, a distribution from a qualified retirement plan, a 403(b) plan, or an IRA received before age 59 1/2, death, or disability generally is subject to a 10-percent early withdrawal tax on the amount included in income, unless an exception applies. A distribution from a qualified retirement plan, a 403(b) annuity, a governmental 457 plan, or an IRA rolled over within 60 days to another plan, annuity or IRA generally is not included in a taxpayer's gross income and not subject to the 10-percent early withdrawal tax. This Act provided an exemption from the 10-percent early withdrawal tax for qualified Hurricane Katrina distributions. A qualified Hurricane Katrina distribution is a distribution from a qualified retirement plan, 403(b) annuity, or IRA made on or after August 25, 2005 and before January 1, 2007 to an individual whose principal place of abode on August 28, 2005 was located in the Hurricane Katrina disaster area and who had sustained an economic loss as a result of the hurricane. The total amount of qualified Hurricane Katrina distributions that an individual can receive from all qualified retirement plans, tax-sheltered annuities, or IRAs is $100,000. Any amount required to be included in income as a result of a qualified Hurricane Katrina distribution may be included in income ratably over the three-year period beginning with the year of distribution. In addition, any portion of a qualified Hurricane Katrina distribution repaid to a qualified retirement plan, tax-sheltered annuity or IRA within three years after the initial distribution is treated as a rollover and thereby excluded from the taxpayer's gross income and exempt from the 10-percent early withdrawal tax.

Provide tax-favored and penalty-free treatment for the recontribution of withdrawals for home purchase cancelled as a result of Hurricane Katrina.—Under current law, certain amounts held in a 401(k) plan or a 403(b) annuity may not be distributed before severance from employment, age 59½, death, disability, or financial hardship of the employee. For this purpose, subject to certain conditions, distribu-

tions for costs directly related to the purchase of a principal residence by an employee (excluding mortgage payments) are deemed to be distributions on account of financial hardship. Current law also allows distributions of up to $10,000 from IRAs for the purchase or construction of a principal residence of a first-time homebuyer. Under this Act, hardship distributions from a 401(k) plan or 403(b) annuity, and qualified first-time homebuyer distributions from an IRA received after February 28, 2005 and before August 29, 2005 for the purchase or construction of a principal residence in the Hurricane Katrina disaster area can be recontributed to such a plan, annuity or IRA if the residence was not purchased or constructed as a result of the hurricane. Any amount recontributed to such a plan is treated as a rollover and thereby excluded from the taxpayer's gross income and exempt from the 10-percent early withdrawal tax.

Modify treatment of loans from qualified retirement plans.—A loan from a qualified retirement plan to a plan participant generally is treated as a taxable distribution under current law. An exception to this general rule is provided to the extent that the loan does not exceed the lesser of (1) $50,000, reduced by the excess of the highest outstanding balance of loans from such plans during the one-year period ending on the day before the date the loan is made over the outstanding balance of loans from the plan on the date the loan is made, or (2) the greater of $10,000 or one half of the participant's accrued benefit under the plan. This Act increased from $50,000 to $100,000 the limit on loans from a qualified retirement plan to an individual whose principal place of abode on August 28, 2005 was located in the Hurricane Katrina disaster area and who sustained an economic loss as a result of Hurricane Katrina. To qualify for the higher limit, the loan must be made after September 23, 2005 and before January 1, 2007.

GULF OPPORTUNITY ZONE ACT OF 2005

This Act, which was signed by President Bush on December 21, 2005, created a Gulf Opportunity Zone (GO Zone), in which additional tax relief was provided to individuals and businesses affected by Hurricane Katrina. This Act also extended many of the tax benefits provided in the Katrina Emergency Tax Relief Act of 2005 to victims of Hurricane Rita and Hurricane Wilma. For purposes of this Act, the "Hurricane Rita disaster area" is that area with respect to which a major disaster was declared by President Bush before October 6, 2005 by reason of Hurricane Rita and the "Hurricane Wilma disaster area" is that area with respect to which a major disaster was declared by President Bush before November 14, 2005 by reason of Hurricane Wilma. The "Gulf Opportunity Zone," "Rita GO Zone," and "Wilma GO Zone," are defined, respectively, as that portion of the Hurricane Katrina, Rita and Wilma disaster areas determined by the President to warrant individual or individual and public assistance. The major provisions of this Act are described below.

Tax Relief for the Gulf Opportunity Zone

Provide tax-exempt bond financing.—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. Under this Act, Alabama, Louisiana, and Mississippi (or any political subdivision thereof) were provided authority to issue tax-exempt private activity bonds for: (1) the cost of any qualified rental project in the Gulf Opportunity Zone (GO Zone); (2) the cost of acquisition, construction, reconstruction, and renovation of nonresidential real property and public utility property in the GO Zone; and (3) the cost of certain owner-occupied residences in the GO Zone. Authority to issue these bonds, which are not subject to the aggregate annual State private activity bond volume limit, expires after December 31, 2010. The maximum aggregate amount of bonds issued in each State is limited to $2,500 multiplied by the population of the State within the GO Zone. Depending on the purpose for which such bonds are issued, they are treated as either exempt facility bonds or qualified mortgage bonds and are subject to the general rules applicable to the issuance of such bonds, except as modified by this Act.

Allow advance refunding of certain tax-exempt bonds.—Refunding bonds are used to pay principal, interest or redemption price on previously issued bonds. Different rules apply to "current" and "advance" refunding bonds. A current refunding occurs when the refunded debt is retired within 90 days of issuance of the refunding bonds. Tax-exempt bonds may be currently refunded an indefinite number of times. An advance refunding occurs when the refunded debt is not retired within 90 days after the refunding bonds are issued; instead, the proceeds of the refunding bonds are invested in an escrow account and held until a future date when the refunded debt may be retired. In general, governmental bonds and tax-exempt private activity bonds for charitable organizations (qualified 501(c)(3) bonds) may be advance refunded one time.

This Act permitted an additional advance refunding of certain governmental and qualified 501(c)(3) bonds issued by Alabama, Louisiana, or Mississippi (or any political subdivision thereof). It also permitted one advance refunding of certain exempt facility bonds for airports, docks, or wharves issued by these States or any political subdivision thereof. Eligible bonds include only those bonds outstanding on August 28, 2005 that could not be advance refunded because of restrictions in effect on that date. The maximum amount of advance refunding bonds that may be issued under this provision by Louisiana, Mississippi and Alabama is $4.5 billion, $2.250 billion, and $1.125 billion, respectively. Eligible advance refunding bonds must be designated as

such by the governor of the respective State and must be issued before January 1, 2011.

Increase and modify the low-income housing tax credit.—A low-income housing tax credit is provided to owners of qualified low-income rental units under current law. The credit may be claimed over a 10-year period for a portion of the cost of rental housing occupied by tenants having incomes below specified levels. The credit percentage for newly constructed or substantially rehabilitated housing that is not federally subsidized is adjusted monthly by the IRS so that the 10 annual credit amounts have a present value of 70 percent of the qualified basis of the structure. The credit percentage for newly constructed or substantially rehabilitated housing that is federally subsidized is calculated to have a present value of 30 percent of the qualified basis of the structure. Buildings located in high cost areas (qualified census tracts and difficult development areas) are eligible for an enhanced credit, provided no more than 20 percent of the population of each metropolitan statistical area or nonmetropolitan statistical area is a difficult development area. Under the enhanced credit, the 70 percent and 30 percent credits are increased to 91 percent and 39 percent, respectively. The aggregate credit authority allocated to each State for calendar year 2006 generally is the greater of $2.180 million or $1.90 per capita. These amounts are indexed annually for inflation. In general, to qualify for the credit, a low-income housing project must satisfy one of two tests: (1) 20 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (2) 40 percent or more of the residential units in the project are both rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income.

Under this Act, for calendar years 2006 through 2008, the otherwise applicable aggregate housing credit authority was increased for each State within the GO Zone. The additional credit amount for each State is equal to $18.00 multiplied by the number of such State's residents within the GO Zone. This amount is not indexed for inflation. For calendar year 2006, the otherwise applicable aggregate housing credit authority amount for both Florida and Texas was increased by $3.5 million. This Act also replaced the area median gross income standards of current law with a national nonmetropolitan median gross income standard, with respect to property placed in service in a nonmetropolitan area within the GO Zone during calendar years 2006, 2007, and 2008. The income targeting rules for property in metropolitan areas in the Go Zone are the same as under current law. In addition, property placed in service in calendar years 2006 through 2008 in the Go Zone, the Rita Go Zone, and the Wilma GO Zone are treated as high-cost areas and eligible for the enhanced credit; the 20 percent of population restriction of current law is waived. The enhanced credit and modified income targeting rules apply regardless of whether the property receives its credit allocation under the otherwise applicable low-income housing authority or the additional credit authority provided in this Act.

Provide special depreciation allowance for certain property.—Taxpayers 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 MACRS, which assigns applicable recovery periods and depreciation methods to different types of property. Under this Act, qualifying GO Zone property is eligible for an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property. The additional first-year deprecation deduction is allowed for both regular and alternative minimum tax purposes in the year the property is placed in service. The basis of the property and the depreciation deductions allowable in other years are adjusted to reflect the additional first-year depreciation deduction. Qualifying property generally must be tangible property with a recovery period of 20 years or less, and also includes: (1) certain computer software; (2) water utility property; (3) leasehold improvement property; (4) nonresidential real property; and (5) residential rental property. In addition: (1) substantially all of the use of the property must be in the GO Zone and in the active conduct of a trade or business by the taxpayer in the GO Zone; (2) the original use of the property in the Go Zone must commence with the taxpayer on or after August 28, 2005; and (3) the property must be acquired by purchase by the taxpayer on or after August 28, 2005 and placed in service on or before December 31, 2007 (December 31, 2008 in the case of nonresidential real property and residential rental property). Property acquired under a binding written contract entered into before August 28, 2005 is not eligible for the additional first-year depreciation deduction provided under this provision. Current law allowed certain property an extended placed-in-service deadline (December 31, 2005) with respect to existing additional first-year depreciation provisions. This Act granted the Department of Treasury authority to extend that deadline for up to one year if such property is placed in service in the GO Zone, the Rita GO Zone or the Wilma GO Zone.

Increase expensing for small business.—Business taxpayers are allowed to expense up to $100,000 in annual investment expenditures for eligible property placed in service in taxable years 2003 through 2007. The amount that may be expensed is reduced by the amount by which the taxpayer's annual 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 2008. Eligible property includes tangible personal property, certain real property, and, currently, off-the-shelf computer software. This Act increased the amount of annual investment expenditures

that business taxpayers are allowed to expense by the lesser of $100,000 or the cost of eligible property that is also qualified GO Zone property placed in service during the taxable year. This Act also increased the phase-out threshold investment amount by the lesser of $600,000 or the cost of eligible property that is also qualified GO Zone property placed in service during the taxable year. Neither of these increased values is indexed for inflation. Qualified GO Zone property is property that meets the requirements needed to qualify for the special depreciation allowance (see discussion in the preceding paragraph).

Allow five-year carryback of certain net operating losses.—A net operating loss (NOL) generally is the amount by which a taxpayer's allowable deductions exceed the taxpayer's gross income. A carryback of an NOL generally results in a refund of Federal income taxes paid for the carryback year. A carryforward of an NOL generally reduces Federal income tax payments for the carryforward year. Under current law, an NOL generally can be carried back two years and carried forward 20 years. This Act provided a special five-year carryback period for NOLs to the extent of certain specified amounts related to Hurricane Katrina or the GO Zone. The amount of the NOL eligible for the five-year carryback is limited to the aggregate amount of the following deductions: (1) qualified GO Zone casualty losses; (2) certain moving expenses; (3) certain temporary housing expenses; (4) depreciation deductions with respect to qualified GO Zone property for the taxable year the property is placed in service; and (5) deductions for certain repair expenses resulting form Hurricane Katrina. The five-year carryback applies to losses paid or incurred after August 27, 2005 and before January 1, 2008.

Increase amount of qualifying investment eligible for the new markets tax credit.—Under current law, the new markets tax credit is provided for qualified equity investments made to acquire stock in a corporation or a capital interest in a partnership that is a qualified community development entity (CDE). A credit of five percent is provided to the investor for the first three years of investment. The credit increases to six percent for the next four years. The maximum amount of annual qualifying equity investment is capped at $2.0 billion for calendar years 2004 and 2005, and $3.5 billion for calendar years 2006 and 2007. This Act increased the annual qualifying equity investment cap by $300 million for 2005 and 2006, and $400 million for 2007. The additional amount is to be allocated among qualified CDEs to make qualified low-income community investments within the GO Zone. To qualify for the allocation, a qualified CDE must have as a significant mission the recovery and redevelopment of the GO Zone.

Provide tax relief for in-kind lodging provided by an employer.—Under current law, employer-provided housing generally is includible in income as compensation and is wages for purposes of social security, Medicare, and unemployment insurance taxes. This Act provided an income tax exclusion for the value of in-kind lodging provided for a month to a qualified employee (and the employee's spouse or dependents) by or on behalf of a qualified employer. The amount of the exclusion for any month for which such lodging is furnished cannot exceed $600. For purposes of this exclusion, a qualified employee is any individual who: (1) on August 28, 2005, had a principal residence in the GO Zone; and (2) performed substantially all of his or her employment services in the Go Zone for the qualified employer furnishing the lodging. A qualified employer is any employer with a trade or business located in the GO Zone. The exclusion, which applies to lodging provided after December 31, 2005 and before July 1, 2006, does not apply for purposes of social security, Medicare or unemployment insurance taxes. This Act also provided a tax credit to qualified employers equal to 30 percent of the value of such lodging excluded from the income of a qualified employee. The amount taken as a credit is not deductible by the employer.

Provide other tax relief.—Other tax relief provided to property and individuals located in the GO Zone included: (1) a deduction for 50 percent of certain clean-up costs; (2) a two-year extension of the current law provision allow expensing of certain environmental remediation costs; (3) an increase in the rehabilitation tax credit with respect to certain buildings; (4) an increase in the expensing limit for reforestation expenditures of certain small timber producers (also applicable to the Rita and Wilma GO Zones); (5) a five-year carryback for certain timber losses (also applicable to the Rita and Wilma GO Zones); (6) a ten-year carryback for certain public utility casualty losses; (7) a new category of tax-credit bonds to be issued by Louisiana, Mississippi and Alabama; (8) modification of the treatment of public utility disaster losses; and (9) expansion of the Hope and Lifetime Learning credits.

Exclude certain property from specific tax benefits.—The provisions of this Act relating to additional first-year depreciation, increased expensing for small business, and the five-year carryback of NOLs do not apply with respect to the following property: (1) any private or commercial golf course, country club, massage parlor, hot tub facility, or suntan facility; (2) any store the principal business of which is the sale of alcoholic beverages for consumption off premises; and (3) any gambling or animal racing property.

Tax Relief for Victims of Hurricanes Rita and Wilma

Provide special rules for the use of retirement funds.—Under the Katrina Emergency Tax Relief Act of 2005, special rules were provided for the use of retirement funds by an individual whose principal place of abode on August 28, 2005 was located in the Hurri-

cane Katrina disaster area and who had sustained an economic loss as a result of the hurricane. These special rules, which are described in greater detail under the discussion of the Katrina Emergency Tax Relief Act of 2005, included the following: (1) tax-favored and penalty-free withdrawals from retirement plans; (2) tax-favored and penalty-free treatment for the recontribution of withdrawals for home purchase cancelled as a result of the hurricane; and (3) modification of the treatment of loans from qualified plans. This Act expanded that relief to apply to: (1) an individual whose principal place of abode on September 23, 2005 was located in the Hurricane Rita disaster area and who sustained an economic loss as a result of the hurricane; and (2) an individual whose principal place of abode on October 23, 2005 was located in the Hurricane Wilma disaster area and who sustained an economic loss as a result of the hurricane.

Provide an employee retention credit to employers affected by Hurricanes Rita and Wilma.—Under the Katrina Emergency Tax Relief Act of 2005, an employee retention credit was provided to employers who employed an average of 200 or fewer employees in a business located in the core Katrina disaster area on August 28, 2005, whose business was inoperable on any day during the period August 28, 2005 through December 31, 2005, as a result of Hurricane Katrina. This Act repealed the employer size limitation, effective for wages paid with respect to Hurricane Katrina on any day after August 28, 2005 and before January 1, 2006. This Act also expanded eligibility for the employee retention credit, as modified to repeal the employer size limitation, to apply to employers affected by Hurricanes Rita and Wilma and located in the Rita GO Zone on September 23, 2005 and in the Wilma GO Zone on October 23, 2005, respectively.

Suspend limitation on charitable contributions.—Deductions for charitable contributions are subject to certain limitations under current law. The Katrina Emergency Tax Relief Act of 2005 temporarily suspended these limitations for corporations and individuals who itemize deductions with respect to cash contributions to certain public charities made after August 27, 2005 and before January 1, 2006. For corporations, the suspension applied only to contributions for relief efforts related to Hurricane Katrina. This Act expanded this temporary suspension to apply to corporate cash contributions for relief efforts related to Hurricanes Rita and Wilma.

Suspend limitation on personal casualty losses.—The Katrina Emergency Tax Relief Act of 2005 suspended both the $100 and 10-percent-of-AGI limitations otherwise applicable to personal casualty losses, with respect to such loses occurring in the Hurricane Katrina disaster area on or after August 25, 2005 and attributable to the hurricane. This Act expanded this suspension to apply to such losses occurring in the Hurricane Rita disaster area on or after September 23, 2005 and the Hurricane Wilma disaster area on or after October 23, 2005.

Provide other tax relief for victims of Hurricane Rita and Hurricane Wilma.—Other tax relief provided to victims of Hurricanes Rita and Wilma included: (1) a special rule for purposes of computing the refundable portion of the child tax credit and the EITC; (2) authority to make adjustments regarding taxpayer and dependency status; and (3) special rules for mortgage revenue bonds.

Other Provisions

Extend election to treat combat pay as earned income for purposes of computing the EITC.—This Act extended for one year, through December 31, 2006, the prior law election that allowed combat pay, which is otherwise excluded from gross income, to be treated as earned income for purposes of calculating the EITC.

Modify the rules regarding the suspension of interest and penalties where the IRS fails to contact the taxpayer.—In general, interest and penalties accrue during periods for which taxes are unpaid, without regard to whether the taxpayer was aware that taxes were due. Beginning 18 months after the filing of a timely return, the accrual of certain penalties and interest is suspended if the IRS failed to send the taxpayer a notice specifically stating the taxpayer's liability and the basis for the liability. Interest and penalties resume 21 days after the required notice is sent to the taxpayer by the IRS. The temporary suspension of certain penalties and interest does not apply to interest accruing after October 3, 2004 with respect to underpayments resulting from listed transactions or undisclosed reportable transactions. This Act expanded the exception for listed transactions and undisclosed reportable transactions to apply to interest accruing on or before October 3, 2004. However, taxpayers remain eligible for the present-law suspension of interest if: (1) the year in which the underpayment occurred is barred by the statute of limitations (or a closing agreement) as of December 14, 2005; (2) it is determined that the taxpayer acted reasonably and in good faith with respect to the transaction; or (3) as of January 23, 2006, the taxpayer participates in the IRS settlement initiative with respect to the transaction. In addition, if a taxpayer files an amended return or other signed written document after December 21, 2005 that shows that the taxpayer owes an additional amount of tax for a given taxable year, the 18-month period is measured from the latest date on which such documents were provided.

Make technical corrections to recently enacted legislation.—This Act also included technical corrections and other corrections to recently enacted tax legislation.

DOMINICAN REPUBLIC-CENTRAL AMERICA-UNITED STATES FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on August 2, 2005, approved and provided for U.S implementation of the Dominican Republic-Central America-United States Free Trade Agreement, as signed by the United States, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and the Dominican Republic. When this Agreement enters into force, it will level the playing field for U.S. farmers, manufacturers and entrepreneurs. This Agreement will expand access for U.S. manufactured goods and agricultural products to a market of 44 million customers. In addition to advancing U.S. economic interests, this Agreement provides a unique opportunity to strengthen our political ties with Central America and the Caribbean, thereby enhancing our Nation's security as democracy, stability and prosperity advance throughout the region.

UNITED STATES-BAHRAIN FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on January 11, 2006, approved and provided for U.S. implementation of the United States-Bahrain Free Trade Agreement, as signed by the United States and Bahrain on September 14, 2004. When this Agreement enters into force, it will provide increased access to Bahrain's markets for U.S. industrial, consumer, and agricultural goods, and create new opportunities for U.S. services firms. In addition to enhancing our bilateral relationship with a strategic friend and ally in the Middle East region and promoting economic growth and prosperity in both nations, this Agreement provides an important opportunity to encourage economic development in a moderate Muslim nation that is a leader of reform in the Gulf region. This Agreement marks a significant step in implementing the President's plan for a broader Middle East Free Trade Area.

ADMINISTRATION PROPOSALS

REFORM THE FEDERAL TAX SYSTEM

Americans deserve a tax system that is simple, fair, and pro-growth—in tune with our dynamic, 21st century economy. The tax system should allow taxpayers to make decisions based on economic merit, free of tax-induced distortions. The bipartisan and unanimous Report of the President's Advisory Panel on Federal Tax Reform has provided a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of today's economy.

The President has proposed several changes that move the tax code in this direction. The Budget includes proposals to make health care more affordable to a mobile labor force, to promote savings for all Americans, to encourage investment by entrepreneurs, and to enhance our competitiveness by lowering the cost of capital. The Budget also recognizes that tax policy analysis needs to account fully for the economic benefits of reform on our economy. In the coming months, the Treasury Department will continue to study reform and engage in a public dialogue on this important issue.

MAKE PERMANENT CERTAIN TAX CUTS ENACTED IN 2001 AND 2003

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.—Business 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 through 2007. 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 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, 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 2007.

Extend permanently provisions expiring in 2010.—Most of the provisions of the 2001 tax cut 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 Individual Retirement Accounts (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 with-

drawal 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 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, 2006 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).

Saving will be further simplified and encouraged by administrative changes already planned for the 2007 filing season that will allow taxpayers to have their tax refunds directly deposited into more than one account. Consequently, taxpayers will be able, for example, to direct that a portion of their tax refunds be deposited into an LSA or RSA.

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 generally 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, 2006.

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 2008. 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 credit could be claimed for taxable years ending after December 31, 2007 and beginning before January 1, 2015. The credit would apply with respect to the first 900,000 IDA accounts opened after December 31, 2007 and before January 1, 2013, and with respect to matching funds for participant contributions that are made after December 31, 2007 and before January 1, 2015.

Encourage Entrepreneurship and Investment

Increase expensing for small business.—Business 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 through 2007. 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 2008. Also, with respect to a taxable year beginning after 2002 and before 2008, taxpayers are permitted to make or revoke expensing elections on amended returns without the consent of the IRS Commissioner. The Administration proposes to increase the amount of annual investment expenditures that taxpayers are allowed to expense to $200,000, and to raise the amount of qualifying investment at which the phase-out begins to $800,000, effective for qualifying property placed in service in taxable years beginning after 2006. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2007.

Invest in Health Care

Expand health savings accounts (HSAs).—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. In addition, individuals are allowed to accumulate funds in a health savings account (HSA) or medical savings account (MSA) on a tax-preferred basis to pay for medical expenses, provided they are covered by an HSA-qualified high-deductible health plan (HDHP), and no other health plan. Under current law, only employer contributions to HSAs are excluded from income for payroll tax purposes.

The Administration proposes that individuals who make after-tax contributions to an HSA would be allowed a credit equal to a percentage of their after-tax contributions to the HSA to offset the employment taxes on their contributions. The credit generally would be 15.3 percent of their HSA contributions, but would be limited by the amount of wages in the payroll tax base. In order to recapture the credit relating to employment taxes for contributions that are not used for medical expenses, the additional tax on non-medical withdrawals would increase to 30 percent, with a 15 percent rate on non-medical distributions after death, disability, or attaining the age of 65.

The Administration proposes to increase the maximum HSA contribution for all eligible individuals. For any year, the maximum HSA contribution would be increased to the bona fide out-of-pocket limit of the high-deductible health plan.

Additional changes would be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans, including: (1) allowing HSA funds to be used tax-free for premiums for the purchase of non-group high-deductible health plans; (2) allowing qualified medical expenses to include any medical expense incurred on or after the first day of HDHP coverage if individuals have established an HSA by their return filing date for that year; (3) allowing employers to contribute existing health reimbursement arrangement (HRA) balances to the HSAs of employees who would be eligible individuals but for the HRA coverage; and (4) excluding from the comparability rules extra employer contributions to HSAs on behalf of employees who are chronically ill or employees who have spouses or dependents who are chronically ill. All of the HSA-related proposals would be effective for years beginning after December 31, 2006.

Provide an above-the-line deduction for high-deductible insurance premiums.—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. Current law also allows individuals to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by an HDHP, and no other health plan.

The Administration proposes to allow individuals who are eligible for an HSA because they are covered under an HDHP in the individual insurance market to deduct the amount of the premium in determining AGI (whether or not the person itemizes deductions). These individuals would also be entitled to an income tax credit to account for employment taxes. Individuals claiming other credits or deductions or covered by public plans or otherwise not eligible to contribute to an HSA would not qualify for the above-the-line deduction or the credit. The credit generally would be 15.3 percent of their HDHP premium payment, but would be limited by the amount of wages in the payroll tax base. The above-the-line deduction and tax credit would be effective for taxable years beginning after December 31, 2006.

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 purchase 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. In addition, individuals are allowed to accumulate funds in an HSA or MSA on a tax-preferred basis to pay for medical expenses, provided they are covered by an HDHP, and no other health plan.

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, 2006, a new refundable tax credit would be provided for the cost of an HDHP purchased by an individual 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 a plan covering one adult, $2,000 for a plan covering two adults, $3,000 for a plan covering two adults and one or more children, and $1,000 for a plan covering only children. The credit would be phased out at an income of $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, 2007, 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. 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.

Improve the Health Coverage Tax Credit.—The Health Coverage Tax Credit (HCTC) was created under the Trade 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 make the requirements for qualified State-based coverage under the HCTC more consistent with the rules applicable under the Health Insurance Portability and Accountability Act (HIPAA) and thus encourage more plans to participate in the HCTC program, the Administration proposes to allow State-based coverage to impose a pre-existing condition restriction for a period of up to 12 months, provided the plan reduces the restriction period by the length of the eligible individual's creditable coverage (as of the date the individual applied for the State-based coverage). This provision would be effective for eligible individuals applying for coverage after December 31, 2006. Also, in order to prevent an individual from losing the benefit of the HCTC just because his or her spouse becomes eligible for Medicare, the Administration proposes to permit spouses of HCTC-eligible individuals to claim the HCTC when the HCTC-eligible individual becomes entitled to Medicare coverage. The spouse, however, would have to be at least 55 years old and meet the other HCTC eligibility requirements. This provision would be effective for taxable years beginning after December 31, 2006.

To improve the administration of the HCTC, the Administration proposes to: (1) modify the definition of "other specified coverage" for "eligible ATAA recipients," to be the same as the definition applied to "eligible TAA recipients;" (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; and (4) for purposes of the State-based coverage rules, permit the 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.

Allow the orphan drug tax credit for certain predesignation 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, 2005.

Provide Incentives for Charitable Giving

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 chari-

table 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, 2005.

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, 2005.

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 undistributed ordinary income for that year and all prior years; (2) capital gains to the extent of the trust's undistributed capital gain for that year and all prior years; (3) other income to the extent of the trust's undistributed other income for that year and all prior years; 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, 2005, 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 in 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, 2005.

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 the above-the-line deduction for qualified out-of-pocket classroom expenses.—Under current law, teachers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses are allowed to deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceeded two percent of AGI. Current law also allows 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). This additional deduction is effective for expenses incurred in taxable years beginning after December 31, 2001 and before January 1, 2006. Unreimbursed expenditures for certain books, supplies, and equipment related to classroom instruction qualify for the above-the-line deduction. Expenses claimed as an above-the-line deduction may 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 in taxable years beginning after December 31, 2005.

Provide Assistance to Distressed Areas

Establish Opportunity Zones.—The Administration proposes to establish authority to designate 20 opportunity zones (14 in urban areas and 6 in rural areas). The zone designation and corresponding incentives would be in effect from January 1, 2007 through December 31, 2016. To qualify to apply for zone status, a community must either have suffered from a significant decline in its economic base over the past decade as measured by the loss of manufacturing and retail establishments and manufacturing jobs, or be a previously designated empowerment zone, renewal community or enterprise community. The Secretary of Commerce would select opportunity zones through a competitive process based on the applicant's "community transition plan" and "statement of economic transition." The community transition plan would have to set concrete, measurable goals for reducing local regulatory and tax barriers to construction, residential development and business creation. The statement of economic transition would have to demonstrate that the local community's economic base is in transition, as indicated

by a declining job base and labor force, and other measures, during the past decade. In evaluating applications, the Secretary of Commerce could consider other factors, including: (1) changes in unemployment rates, poverty rates, household income, homeownership and labor force participation; (2) the educational attainment and average age of the population; and (3) for urban areas, the number of mass layoffs occurring in the area's vicinity over the previous decade. Empowerment zones and renewal communities designated as opportunity zones would not count against the limitation of 20 new opportunity zones. Such communities would be required to relinquish their current status and benefits once selected. Opportunity zone benefits for converted empowerment zones and renewal communities would expire on December 31, 2010. Tax benefits for enterprise communities expired at the end of 2004. Enterprise communities designated as opportunity zones would count against the limitation of 20 new zones and opportunity zone benefits would be in effect through 2016.

A number of tax incentives would be applicable to opportunity zones. First, a business would be allowed to exclude 25 percent of its taxable income if it qualified as an "opportunity zone business" and it satisfied a $5 million gross receipts test. The definition of an opportunity zone business would be based on the definition of a "qualified active low-income community business" for purposes of the new markets tax credit, treating opportunity zones as low-income communities. Second, an opportunity zone business would be allowed to expense the cost of section 179 property that is qualified zone property, up to an additional $100,000 above the amounts generally available under current law. Third, a commercial revitalization deduction would be available for opportunity zones in a manner similar to the deduction for renewal communities. A $12 million annual cap on these deductions would apply to each opportunity zone. Finally, individuals who live and work in an opportunity zone would constitute a new target group with respect to wages earned within the zone under the proposed combined work opportunity tax credit and welfare-to-work tax credit (see discussion later in this Chapter).

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2006, to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. The Administration proposes to extend this provision permanently making it available for expenditures paid or incurred after December 31, 2005, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Restructure Assistance to New York City

Provide tax incentives for transportation infrastructure.—The Administration proposes to restructure the tax benefits for New York recovery that were enacted in 2002. Some of the tax benefits that were provided to New York following the attacks of September 11, 2001, likely will not be usable in the form in which they were originally provided. As such, the Administration proposed in the Mid-Session Review of the 2005 Budget to sunset certain existing New York Liberty Zone tax benefits and in their place provide tax credits to New York State and New York City for expenditures incurred in building or improving transportation infrastructure in or connecting with the New York Liberty Zone. The tax credit would be available as of the date of enactment, subject to an annual limit of $200 million ($2 billion in total over 10 years), evenly divided between the State and the City. Any unused credit limit in a given year would be added to the $200 million allowable in the following year, including years beyond the 10-year period of the credit. Similarly, expenditures that could not be credited in a given year because of the credit limit would be carried forward and used against the next year's limitation. The credit would be allowed against any payments (e.g., income tax withholding) made by the City and State under any provision of the Internal Revenue Code, other than Social Security and Medicare payroll taxes and excise taxes. The Secretary of the Treasury may prescribe such rules as are necessary to ensure that the expenditures are made for the intended purpose.

Repeal certain New York City Liberty Zone incentives.—The Administration proposes to terminate the following tax incentives provided to qualified property within the New York Liberty Zone under the 2002 economic stimulus act: (1) the additional first-year depreciation deduction; (2) the five-year recovery period for leasehold improvement property; (3) increased expensing for small businesses; and (4) the extended replacement period for the nonrecognition of gain on involuntarily converted property. These terminations are proposed to be effective on the date of enactment. Property placed in service after the date of enactment would not be eligible for the first three incentives listed above unless a binding written contract was in effect on the date of enactment, in which case the property would need to be placed in service by the original termination dates provided in the 2002 economic stimulus act. Other related changes to the Internal Revenue Code would be made as appropriate.

SIMPLIFY THE TAX LAWS FOR FAMILIES

Clarify uniform definition of a child.—The 2004 tax relief act created a uniform definition of a child, allowing, in many circumstances, a taxpayer to claim the same child for five different child-related tax benefits. Under the new rules, a qualifying child must meet relationship, residency, and age tests. While the new

rules simplify the determination of eligibility for many child-related tax benefits, the elimination of certain complicated factual tests to determine if siblings and certain other family members are eligible to claim a qualifying child may have some unintended consequences. The new rules effectively deny the EITC to some young taxpayers who are the sole guardians of their younger siblings. Yet some taxpayers are able to avoid income limitations on child-related tax benefits by allowing other family members, who have lower incomes, to claim the taxpayers' sons or daughters as qualifying children. The 2004 tax relief act had other unintended consequences, which made some of the eligibility rules less uniform. For example, it allowed dependent filers to claim the child tax credit, even though they are generally ineligible for most other child-related tax benefits. It also allowed taxpayers to claim the child tax credit on behalf of a married child who files a joint return with his or her spouse, even though the taxpayer generally cannot claim other benefits for the married child. These exceptions create confusion and add complexity.

To ensure that deserving taxpayers receive child-related tax benefits, the Administration proposes to clarify the uniform definition of a child. First, the definition of a qualifying child would be further simplified. A taxpayer would not be a qualifying child of another individual if the taxpayer is older than that individual. However, an individual could be a qualifying child of a younger sibling if the individual is permanently and totally disabled. Also, under the proposal, an individual who is married and filing jointly (for any reason other than to obtain a refund of overwithheld taxes) would not be considered a qualifying child for the child-related tax benefits, including the child tax credit. Second, the proposal clarifies when a taxpayer is eligible to claim child-related tax benefits. If a parent resides with his or her child for over half the year, the parent would be the only individual eligible to claim the child as a qualifying child. The parent could waive the child-related tax benefits to another member of the household who has higher adjusted gross income and is otherwise eligible for the tax benefits. In addition, dependent filers would not be allowed to claim qualifying children. The proposal is effective for taxable years beginning after December 31, 2006.

Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigrant status.—To qualify for the EITC, taxpayers must satisfy requirements regarding filing status, the presence of children in their households, 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 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, 2006.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $11,300 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. About 70 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, 2006.

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.

Strengthen funding for single-employer pension plans.—Under current law, defined benefit pension plans are subject to minimum funding requirements imposed under both the Internal Revenue Code and

the Employee Retirement Income Security Act of 1974 (ERISA). In the case of a qualified plan, the Internal Revenue Code excludes such contributions from gross income and allows a deduction for the contributions, subject to certain limits on the maximum deductible amount. The calculation of the minimum funding requirements and the limits on deductible contributions are determined under a series of complex rules and measures of assets and liability, many of which are manipulable and none of which entail the use of an accurate measure of the plan's assets and its true liabilities.

The Administration proposes rationalizing the multiple sets of funding rules applicable to single-employer defined benefit plans and replacing them with a single set of rules that provide for: (1) funding targets that are based on meaningful, accurate measures of liabilities that reflect the financial health of the employer; (2) the use of market value of assets; (3) a seven-year amortization period for funding shortfalls; (4) the opportunity for an employer to make additional deductible contributions in good years, even when the plan's assets are above the funding target; and (5) meaningful consequences for employers and plans whose funded status does not improve.

These funding rules changes and the addition of meaningful consequences for employers and plans whose funded status does not improve and improved disclosure to plan participants, investors and regulators are part of an overall package of reforms that will improve the health of defined benefit pensions and the PBGC guarantee system. As described in Chapter 7 of Analytical Perspectives and the Department of Labor Chapter of the Budget volume, this overall package includes reform of the premium structure for the PBGC, revision in the application of the PBGC guarantee rates and changes to the bankruptcy law.

Reflect market interest rates in lump sum payments.—Current law generally requires that a lump sum paid from a pension plan be calculated using the rate of interest on 30-year Treasury securities (or a close proxy) for the month preceding the distribution. The Administration proposes that the value of the lump sum reflect market interest rates and the timing of the expected benefit payments for which the lump sum is calculated. This would ensure that the value of the lump sum is equivalent to the value of the annuity. Lump sums would be calculated using interest rates that are drawn from a zero-coupon corporate bond yield curve. The yield curve would be issued monthly by the Secretary of the Treasury and would be based on the interest rates (averaged over 90 business days) for high quality corporate bonds with varying maturities. In order to avoid disruptions, the proposal would be phased in for plan years beginning in 2008 and 2009 and would not be fully effective until the plan year beginning in 2010.

CLOSE LOOPHOLES AND IMPROVE TAX COMPLIANCE

Combat abusive foreign tax credit transactions.—Current law allows taxpayers a credit against U.S. taxes for foreign taxes incurred with respect to foreign income, subject to specified limits. The Administration proposes to provide the Department of Treasury with supplemental regulatory authority, in addition to its broad existing authority, to ensure that the foreign tax credit rules cannot be used to achieve inappropriate results that are not consistent with the underlying economics of the transactions in which the foreign tax credits arise. The regulatory authority would enhance the ability of the Department of Treasury to prevent the inappropriate separation of foreign taxes from the related foreign income. Regulations could provide for the disallowance of a credit for all or a portion of the foreign taxes or the reallocation of the foreign taxes among the participants to the transaction.

Modify the active trade or business test.—Current law allows corporations to avoid recognizing gain in certain spin-off and split-off transactions provided that, among other things, the active trade or business test is satisfied. The active trade or business test requires that immediately after the distribution, the distributing corporation and the corporation the stock of which is distributed (the controlled corporation) be engaged in a trade or business that has been actively conducted throughout the five-year period ending on the date of the distribution. There is no statutory requirement that a certain percentage of the distributing corporation's or controlled corporation's assets be used in that active trade or business in order for the active trade or business test to be satisfied. Because certain non-pro rata distributions resemble redemptions for cash, the Administration proposes to require that in the case of a non-pro rata distribution, in order for a corporation to satisfy the active trade or business test, as of the date of the distribution, at least 50 percent of its assets, by value, must be used or held for use in a trade or business that satisfies the active trade or business test.

Impose penalties on charities that fail to enforce conservation easements.—Although gifts of partial interests in property generally are not deductible as charitable contributions, current law allows a deduction for certain restrictions granted in perpetuity on the use that may be made of real property (such as an easement). A deduction is allowed only if the contribution is made to a qualified organization exclusively for conservation purposes. To qualify to receive such qualified conservation contributions, a charity must have a commitment to protect the conservation purposes of the donation and have the resources to enforce the restrictions. The Department of Treasury is concerned that in some cases charities are failing to monitor and enforce the conservation restrictions for which charitable

contribution deductions were claimed. The proposal would impose significant penalties on any charity that removes or fails to enforce such a conservation restriction, or transfers the easement without ensuring that the conservation purposes will be protected in perpetuity. The amount of the penalty would be determined based on the value of the easement shown on the appraisal summary provided to the charity by the donor. The Secretary of the Treasury would be authorized to waive the penalty in certain circumstances. The Secretary of the Treasury also would be authorized to require such additional reporting as may be necessary or appropriate to ensure that the conservation purposes are protected in perpetuity.

Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields.—In general, an organization that is otherwise exempt from Federal income tax is taxed on income from any trade or business regularly carried on by the organization that is not substantially related to the organization's exempt purposes. In addition, income derived from property that is debt-financed generally is subject to unrelated business income tax. The 2004 job creation act created a special exclusion from unrelated business taxable income of gain or loss from the sale or exchange of certain qualifying brownfield properties. The exclusion applies regardless of whether the property is debt-financed. The new provision adds considerable complexity to the Internal Revenue Code and, because there is no limit on the amount of tax-free gain, could exempt from tax real estate development considerably beyond mere environmental remediation. The proposal would eliminate this special exclusion effective for taxable years beginning after December 31, 2006.

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, 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. The Department of Treasury also is conducting a study of these rules and the potential for further modifications to ensure the prevention of inappropriate income-reduction opportunities.

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 account. In addition, current law creates opportunities for inappropriate use of these accounts. The proposal would simplify the tax consequences under these programs and promote use of these accounts to save for higher education. The most significant change made by this proposal is the elimination of substantially all post-contribution transfer taxes, thus permitting tax-free changes of the designated beneficiary of an account, without limitation as to the relationship or number of generations between the current and former beneficiaries. Any distribution used to pay the beneficiary's qualified higher education expenses would continue to be tax-free. However, to eliminate the potential transfer tax benefit of using an account for purposes not intended by the statute, any distribution that is not used for higher education expenses generally 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. Distributions from an account would be permitted to be made only to or for the benefit of the designated beneficiary. However, a contributor who sets up an account would be permitted to withdraw funds from the account during the contributor's life, subject to income tax on the income portion of the withdrawal. The income portion of a withdrawal by the account's contributor generally also would be subject to an additional tax to discourage individuals from using these accounts to save for retirement. The proposal would be effective for Section 529 accounts established after the date of enactment, and no additional contributions would be permitted to pre-existing Section 529 savings accounts unless those accounts elect to be governed by the new rules.

TAX ADMINISTRATION, UNEMPLOYMENT INSURANCE, AND OTHER

Improve Tax Administration

Implement IRS administrative reforms.—The proposed modification to the IRS Restructuring and Reform Act of 1998 is comprised of five 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 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 Secretary of the Treasury 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 continuous levies against income and would also be credited against the taxpayer's liability. The second proposal would provide the IRS additional authority to require electronic filing. This proposal would allow the IRS to process more returns and payments efficiently.

Allow IRS to access information in the National Directory of New Hires for tax administration purposes.—The National Directory of New Hires (NDNH), an electronic database maintained by the Department of Health and Human Services, contains timely, uniformly compiled employment data from State agencies across the country. Currently, the IRS may obtain data from the NDNH, but only for limited purposes. Access to NDNH data for tax administration purposes generally would make the IRS more productive by reducing the amount of resources it must dedicate to obtaining and processing data. The Administration proposes to amend the Social Security Act to allow the IRS access to NDNH data for general tax administration purposes, including data matching, verification of taxpayer claims during return processing, preparation of substitute returns for non-compliant taxpayers, and identification of levy sources. Data obtained by the IRS from the NDNH would be protected by existing taxpayer privacy law, including civil and criminal sanctions. The proposal would be effective on the date of enactment.

Extend IRS authority to fund undercover operations.—Current law places the IRS on equal footing with other Federal law enforcement agencies by permitting the IRS to fund certain necessary and reasonable expenses of undercover operations. These undercover operations include international and domestic money laundering and narcotics operations. The Administration proposes to extend this funding authority, which expires on December 31, 2006, through December 31, 2010.

Reduce the tax gap.—While the vast majority of American taxpayers pay their taxes timely and accurately, the nation still has a significant tax gap, which is the difference between what taxpayers should pay and what they actually pay on a timely basis. The IRS has taken a number of steps to bolster enforcement; however, it is unlikely that IRS will be able to narrow the tax gap to an acceptable level through enforcement alone. In an effort to reduce the tax gap with minimum taxpayer burden, the Administration proposes to: (1) Clarify the circumstances in which employee leasing companies and their clients can be held jointly liable for Federal employment taxes. (2) Require debit and credit card issuers to report to the IRS gross reimbursements paid to certain businesses. (3) Require increased information reporting for certain non-wage payments made by Federal, State and local governments to procure property and services. (4) Amend collections due process procedures applicable to Federal employment taxes. (5) Expand return preparer identification and penalty provisions. In addition, the Department of Treasury will study the standards used to distinguish between employees and independent contractors for purposes of withholding and paying Federal employment taxes.

Strengthen Financial Integrity of Unemployment Insurance

Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance.—The Administration has a multi-part proposal to strengthen the financial integrity of the unemployment insurance (UI) system and to encourage the early reemployment of UI beneficiaries. The Administration's proposal will boost States' ability to recover benefit overpayments and deter tax evasion schemes by permitting them to use a portion of recovered funds to expand enforcement efforts in these areas. In addition, the proposal would require States to impose a monetary penalty on UI benefit fraud, which would be used to reduce overpayments; make it easier for States to use private collection agencies in the recovery of hard-to-collect overpayments and delinquent employer taxes; require States

to charge employers found to be at fault when their actions lead to overpayments; permit collection of delinquent UI overpayments and employer taxes through garnishment of Federal tax refunds; and improve the accuracy of hiring data in the National Directory of New Hires, which would reduce benefit overpayments. The Administration's proposal would also permit States to request waivers of certain Federal requirements in order to carry out demonstration projects that speed reemployment of individuals eligible for UI. These efforts to strengthen the financial integrity of the UI system and encourage early reemployment of UI beneficiaries will keep State UI taxes down and improve the solvency of the State trust funds.

Extend unemployment insurance surtax.—The unemployment insurance surtax of 0.2 percent imposed on employers is scheduled to expire with respect to wages paid after December 31, 2007. This tax is proposed to be extended for five years, through December 31, 2012.

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 had a fixed ceiling on what it may collect 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.

MODIFY ENERGY POLICY ACT OF 2005

Repeal reduced recovery period for natural gas distribution lines.—The Energy Policy Act of 2005 reduced the recovery period for certain natural gas distribution lines from 20 years to 15 years (see the discussion of the Energy Policy Act of 2005 in this Chapter). The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2006.

Modify amortization for certain geological and geophysical expenditures.—Under the Energy Policy Act of 2005, geological and geophysical expenditures paid or incurred in taxable years beginning after August 8, 2005, in connection with oil and gas exploration in the United States, may be amortized over two years. The Administration proposes to increase the amortization period to five years for amounts paid or incurred in taxable years beginning after December 31, 2006.

PROMOTE TRADE

Implement free trade agreements.—Free trade agreements continue to be negotiated with Thailand, Colombia, Ecuador, Panama, and the United Arab Emirates (UAE), with an expectation—once completed—that the 10-year implementation will begin as early as FY 2007. The recently completed agreements with Oman and Peru could also begin implementation in 2007. A free trade agreement is expected to be completed with the Southern African Customs Union (SACU), with 10-year implementation to begin in FY 2008. These agreements will continue the Administration's effort to use free trade agreements to benefit U.S. consumers and producers as well as strengthen the economies of our partner countries.

Extend Generalized System of Preferences (GSP).—Under GSP, duty-free access is provided to approximately 3,400 products from eligible beneficiary developing countries that meet certain worker rights, intellectual property protection, and other statutory criteria. The Administration proposes to extend this program, which is scheduled to expire after December 31, 2006, through December 31, 2011.

EXTEND EXPIRING PROVISIONS

Extend minimum tax relief for individuals.—A temporary provision of current law increased the alternative minimum tax (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, 2005, the AMT exemption amounts 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 2006.

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, 2006. The Administration proposes to extend minimum tax relief for nonrefundable personal credits for one year, to apply to taxable year 2006. 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.

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 expired on December 31, 2005.

In addition, the Administration is concerned that features of the R&E tax credit may limit its effectiveness in encouraging taxpayers to invest in R&E. The Administration will work closely with the Congress to develop

and enact reforms to modernize the R&E tax credit and improve its incentive effect.

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, 2006.

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, 2006.

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 to individuals who begin work after December 31, 2005 and before January 1, 2007.

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, 2005. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2005 and before January 1, 2007.

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 2005. 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 2005 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 calendar year 2006; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

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 expires on December 31, 2006, through December 31, 2007.

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 $0.55 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 $0.50 per ton and $0.25 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.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Make Permanent Certain Tax Cuts Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	288	571	–1,329	–14,161	–537	–6,545	–22,001	–128,050
Capital gains tax rate structure	.....	.....	.....	–14,183	–5,519	–6,606	–26,308	–74,931
Expensing for small business	.....	.....	–4,679	–6,498	–4,872	–3,853	–19,902	–32,620
Marginal individual income tax rate reductions	.....	.....	.....	.....	.....	–66,918	–66,918	–605,961
Child tax credit [1]	.....	.....	.....	.....	.....	–5,452	–5,452	–116,691
Marriage penalty relief [2]	.....	.....	.....	.....	.....	–4,968	–4,968	–37,578
Education incentives	.....	.....	.....	.....	3	–1,098	–1,095	–10,960
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	–205	–1,102	–1,728	–2,181	–2,676	–23,758	–31,445	–339,022
Modifications of pension plans	.....	.....	.....	.....	.....	–346	–346	–2,858
Other incentives for families and children	.....	.....	.....	.....	5	–170	–165	–4,362
Total make permanent certain tax cuts enacted in 2001 and 2003	83	–531	–7,736	–37,023	–13,596	–119,714	–178,600	–1,353,033
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	.....	4,796	10,407	7,507	3,970	–383	26,297	–122
Consolidate employer-based savings accounts	.....	.....	–542	–579	–618	–1,826	–3,565	–20,063
Establish Individual Development Accounts (IDAs)	.....	.....	–134	–286	–326	–300	–1,046	–1,763
Total simplify and encourage saving	.....	4,796	9,731	6,642	3,026	–2,509	21,686	–21,948
Encourage entrepreneurship and investment:								
Increase expensing for small business	.....	–2,522	–3,527	–2,625	–2,037	–1,645	–12,356	–18,713
Invest in health care:								
Expand health savings accounts (HSAs) [3]	.....	–1,978	–4,321	–6,201	–7,720	–8,826	–29,046	–87,212
Provide an above-the-line deduction for high-deductible insurance premiums [4]	.....	–2,519	–3,815	–3,840	–3,691	–3,668	–17,533	–38,127
Provide refundable tax credit for the purchase of health insurance [5]	.....	–254	–861	–1,194	–1,404	–1,362	–5,075	–11,154
Improve the Health Coverage Tax Credit [6]	.....	–1	–3	–4	–5	–5	–18	–51
Allow the orphan drug tax credit for certain pre-designation expenses [7]	.....	.....	.....	.....	.....	.....	.....	.....
Total invest in health care	.....	–4,752	–9,000	–11,239	–12,820	–13,861	–51,672	–136,544
Provide incentives for charitable giving:								
Permit tax-free withdrawals from IRAs for charitable contributions	.....	–102	–510	–512	–501	–497	–2,122	–4,706
Expand and increase the enhanced charitable deduction for contributions of food inventory	.....	–44	–96	–106	–116	–127	–489	–1,345
Reform excise tax based on investment income of private foundations	.....	–56	–85	–90	–96	–102	–429	–1,074
Modify tax on unrelated business taxable income of charitable remainder trusts	.....	–1	–6	–6	–6	–6	–25	–62
Modify basis adjustment to stock of S corporations contributing appreciated property	.....	–3	–15	–21	–25	–28	–92	–301
Repeal the $150 million limitation on qualified 501(c)(3) bonds	.....	–2	–3	–6	–10	–11	–32	–81
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	.....	–2	–5	–9	–16	–24	–56	–278
Total provide incentives for charitable giving	.....	–210	–720	–750	–770	–795	–3,245	–7,847
Strengthen education:								
Extend the above-the-line deduction for qualified out-of-pocket classroom expenses	–17	–171	–178	–180	–183	–185	–897	–1,867
Provide assistance to distressed areas:								
Establish Opportunity Zones	.....	–221	–411	–439	–451	–482	–2,004	–4,960
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	–98	–146	–163	–177	–168	–157	–811	–1,503
Restructure assistance to New York City:								
Provide tax incentives for transportation infrastructure	.....	–200	–200	–200	–200	–200	–1,000	–2,000
Repeal certain New York City Liberty Zone incentives	.....	200	200	200	200	200	1,000	2,000
Total restructure assistance to New York City	.....	.....	.....	.....	.....	.....	.....	.....
Total tax incentives	–115	–3,226	–4,268	–8,768	–13,403	–19,634	–49,299	–193,382

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Simplify the Tax Laws for Families:								
Clarify uniform definition of a child [8]	.....	17	66	50	32	48	213	395
Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigration status [9]	.....	27	–24	–21	–26	–28	–72	–207
Reduce computational complexity of refundable child tax credit [10]	.....	.....	.....	.....	.....	.....	.....	.....
Total simplify the tax laws for families	.....	44	42	29	6	20	141	188
Strengthen the Employer-Based Pension System:								
Ensure fair treatment of older workers in cash balance conversions and protect defined benefit plans	3	53	62	77	89	100	381	1,039
Strengthen funding for single-employer pension plans	.....	536	2,290	–153	–2,336	–1,611	–1,274	–9,180
Reflect market interest rates in lump sum payments	.....	.....	–3	–9	–17	–24	–53	–274
Total strengthen the employer-based pension system	3	589	2,349	–85	–2,264	–1,535	–946	–8,415
Close Loopholes and Improve Tax Compliance:								
Combat abusive foreign tax credit transactions	.....	1	2	2	3	3	11	26
Modify the active trade or business test	.....	6	8	8	8	8	38	89
Impose penalties on charities that fail to enforce conservation easements	.....	3	8	8	9	9	37	91
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	.....	2	14	30	43	41	130	201
Limit related party interest deductions	.....	82	141	148	155	163	689	1,635
Clarify and simplify qualified tuition programs	.....	4	12	13	14	20	63	222
Total close loopholes and improve tax compliance	.....	98	185	209	232	244	968	2,264
Tax Administration, Unemployment Insurance, and Other:								
Improve tax administration:								
Implement IRS administrative reforms and initiate cost saving measures [11]	.....	.....	.....	.....	.....	.....	.....	.....
Reduce the tax gap	.....	259	351	311	296	308	1,525	3,560
Total improve tax administration	.....	259	351	311	296	308	1,525	3,560
Strengthen financial integrity of unemployment insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [12]	.....	.....	31	30	–106	–143	–188	–2,246
Extend unemployment insurance surtax [12]	.....	.....	1,085	1,490	1,526	1,564	5,665	710
Total strengthen integrity of unemployment insurance [12]	.....	.....	1,116	1,520	1,420	1,421	5,477	–1,536
Other proposals:								
Increase Indian gaming activity fees	.....	.....	5	5	5	5	20	45
Total tax administration, unemployment insurance, and other [12]	.....	259	1,472	1,836	1,721	1,734	7,022	2,069
Modify Energy Policy Act of 2005:								
Repeal reduced recovery period for natural gas distribution lines	.....	12	44	80	112	125	373	833
Modify amortization for certain geological and geophysical expenditures	.....	38	140	206	169	88	641	730
Total modify Energy Policy Act of 2005	.....	50	184	286	281	213	1,014	1,563
Promote Trade:								
Implement free trade agreements [12]	.....	–236	–456	–593	–741	–832	–2,858	–8,200
Extend GSP [12]	.....	–412	–617	–666	–723	–786	–3,204	–3,445
Total promote trade [12]	.....	–648	–1,073	–1,259	–1,464	–1,618	–6,062	–11,645
Extend Expiring Provisions:								
Minimum tax relief for individuals	–13,664	–20,495	.....	.....	.....	.....	–20,495	–20,495
Research & Experimentation (R&E) tax credit	–2,097	–4,601	–5,944	–6,889	–7,669	–8,340	–33,443	–86,440
Combined work opportunity/welfare-to-work tax credit	–80	–144	–86	–25	–7	–3	–265	–266
First-time homebuyer credit for DC	–1	–18	.....	.....	.....	.....	–18	–18
Authority to issue Qualified Zone Academy Bonds	–3	–8	–13	–18	–20	–20	–79	–179
Disclosure of tax return information related to terrorist activity [7]	.....	.....	.....	.....	.....	.....	.....	.....
Excise tax on coal [12]	.....	.....	.....	.....	.....	.....	.....	750
Total extend expiring provisions [12]	–15,845	–25,266	–6,043	–6,932	–7,696	–8,363	–54,300	–106,648

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS—Continued

(in millions of dollars)

	2006	2007	2008	2009	2010	2011	2007–11	2007–16
Total budget proposals, including proposals assumed in the baseline [12]	–15,874	–28,631	–14,888	–51,707	–36,183	–148,653	–280,062	–1,667,039
Total budget proposals, excluding proposals assumed in the baseline [12]	–15,957	–28,100	–7,152	–14,684	–22,587	–28,939	–101,462	–314,006

[1] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $45 million for 2011 and $51,809 million for 2007–2016.

[2] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$371 million for 2011 and $7,346 million for 2007–2016.

[3] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $91 million for 2007, $178 million for 2008, $253 million for 2009, $310 million for 2010, $352 million for 2011, $1,184 million for 2007–2011 and $3,500 million for 2007–2016.

[4] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $244 million for 2007, $315 million for 2008, $319 million for 2009, $303 million for 2010, $305 million for 2011, $1,486 million for 2007–2011 and $3,200 million for 2007–2016.

[5] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $381 million for 2007, $747 million for 2008, $1,095 million for 2009, $1,249 million for 2010, $1,343 million for 2011, $4,815 million for 2007–2011 and $12,939 million for 2007–2016.

[6] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is $4 million for 2007, $10 million for 2008, $12 million for 2009, $14 million for 2010, $15 million for 2011, $55 million for 2007–2011 and $139 million for 2007–2016.

[7] No net budgetary impact.

[8] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$170 million for 2008, –$196 million for 2009, –$250 million for 2010, –$234 million for 2011, –$850 million for 2007–2011 and –$2,224 million for 2007–2016.

[9] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$188 million for 2007, $123 million for 2008, $102 million for 2009, $96 million for 2010, $95 million for 2011, $228 million for 2007–2011 and $687 million for 2007–2016.

[10] Affects both receipts and outlays. Only the receipt effect is shown here. The outlay effect is –$332 million for 2008, –$342 million for 2009, –$347 million for 2010, –$357 million for 2011, –$1,378 million for 2007–2011 and –$3,263 million for 2007–2016.

[11] Outlays from this proposal will be reflected in the Financial Management Service's budget.

[12] Net of income offsets.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Individual income taxes (federal funds):							
Existing law	927,222	1,011,324	1,118,314	1,215,823	1,309,725	1,393,917	1,587,316
Proposed Legislation	.....	–13,725	–21,948	–7,339	–41,279	–23,785	–120,447
Total individual income taxes	**927,222**	**997,599**	**1,096,366**	**1,208,484**	**1,268,446**	**1,370,132**	**1,466,869**
Corporation income taxes:							
Federal funds:							
Existing law	278,278	279,273	265,124	274,333	286,170	292,789	302,649
Proposed Legislation	.....	–2,151	–4,557	–5,835	–9,034	–10,829	–10,637
Total Federal funds corporation income taxes	278,278	277,122	260,567	268,498	277,136	281,960	292,012
Trust funds:							
Hazardous substance superfund	4	.....	.....	.....	.....	.....	.....
Total corporation income taxes	**278,282**	**277,122**	**260,567**	**268,498**	**277,136**	**281,960**	**292,012**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	493,646	521,440	549,083	580,545	612,254	648,363	685,218
Disability insurance (Off-budget)	83,830	88,525	93,236	98,584	103,968	110,099	116,357
Hospital insurance	166,068	177,592	187,940	198,380	209,455	221,926	234,675
Railroad retirement:							
Social Security equivalent account	1,836	1,866	1,937	1,986	2,032	2,066	2,105
Rail pension and supplemental annuity	2,284	2,360	2,322	2,365	2,421	2,471	2,520
Total employment and general retirement	747,664	791,783	834,518	881,860	930,130	984,925	1,040,875
On-budget	170,188	181,818	192,199	202,731	213,908	226,463	239,300
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
Unemployment insurance:							
Deposits by States [1]	35,076	37,477	38,100	38,644	38,814	40,574	43,294
Proposed Legislation	.....	.....	.....	39	38	–132	–178
Federal unemployment receipts [1]	6,829	7,269	7,084	5,911	5,585	5,946	6,689
Proposed Legislation	.....	.....	.....	1,356	1,862	1,907	1,955
Railroad unemployment receipts [1]	97	86	90	104	119	122	122
Total unemployment insurance	42,002	44,832	45,274	46,054	46,418	48,417	51,882
Other retirement:							
Federal employees' retirement—employee share	4,409	4,423	4,285	4,186	4,083	3,989	3,895
Non-Federal employees retirement [2]	50	49	49	49	48	48	46
Total other retirement	4,459	4,472	4,334	4,235	4,131	4,037	3,941
Total social insurance and retirement receipts	**794,125**	**841,087**	**884,126**	**932,149**	**980,679**	**1,037,379**	**1,096,698**
On-budget	216,649	231,122	241,807	253,020	264,457	278,917	295,123
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
Excise taxes:							
Federal funds:							
Alcohol taxes	8,111	8,179	8,299	8,454	8,617	8,768	8,967
Proposed Legislation	.....	–69	–95	–24	.....	.....	.....
Tobacco taxes	7,920	7,710	7,570	7,437	7,312	7,197	7,081
Transportation fuels tax	–770	–1,948	–2,451	–2,814	–2,921	–3,226	–780
Telephone and teletype services	6,047	6,069	6,106	6,143	6,182	6,222	6,261
Other Federal fund excise taxes	1,239	1,080	1,300	1,373	1,423	1,477	1,534
Proposed Legislation	.....	69	58	–3	–29	–42	–60
Total Federal fund excise taxes	22,547	21,090	20,787	20,566	20,584	20,396	23,003
Trust funds:							
Highway	37,892	39,066	39,727	40,576	41,415	42,190	42,974
Airport and airway	10,314	10,651	11,341	11,995	12,694	13,436	14,222

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2005 Actual	Estimate					
		2006	2007	2008	2009	2010	2011
Sport fish restoration and boating	429	524	539	554	571	587	603
Tobacco	899	1,033	955	955	955	955	955
Black lung disability insurance	610	602	617	634	646	653	660
Inland waterway	91	81	77	76	77	78	80
Oil spill liability	.....	88	183	192	203	212	223
Vaccine injury compensation	123	182	186	188	190	192	194
Leaking underground storage tank	189	194	196	201	206	207	210
Total trust funds excise taxes	50,547	52,421	53,821	55,371	56,957	58,510	60,121
Total excise taxes	**73,094**	**73,511**	**74,608**	**75,937**	**77,541**	**78,906**	**83,124**
Estate and gift taxes:							
Federal funds	24,764	27,521	24,925	26,041	27,603	21,504	18,688
Proposed Legislation	.....	2	–1,225	–1,655	–1,591	–1,356	–17,133
Total estate and gift taxes	**24,764**	**27,523**	**23,700**	**24,386**	**26,012**	**20,148**	**1,555**
Customs duties:							
Federal funds	22,260	24,693	27,643	31,437	31,863	34,246	36,559
Proposed Legislation	.....	.....	–864	–1,432	–1,679	–1,951	–2,158
Trust funds	1,119	1,194	1,290	1,392	1,515	1,655	1,809
Total customs duties	**23,379**	**25,887**	**28,069**	**31,397**	**31,699**	**33,950**	**36,210**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	342	342	443	438	438	438	438
Proposed Legislation	.....	.....	.....	5	5	5	5
Exercise of warrants	1	.....	.....	.....	.....	.....	.....
United Mine Workers of America combined benefit fund	125	119	128	125	122	119	117
Deposit of earnings, Federal Reserve System	19,297	27,455	32,679	35,431	38,454	41,282	43,686
Defense cooperation	46	8	8	8	8	8	8
Fees for permits and regulatory and judicial services	9,825	10,110	10,442	10,609	10,860	11,018	11,304
Fines, penalties, and forfeitures	3,149	4,583	4,572	2,643	2,657	2,670	2,682
Gifts and contributions	234	201	200	204	206	208	209
Refunds and recoveries	–26	–56	–56	–56	–56	–56	–56
Total miscellaneous receipts	**32,993**	**42,762**	**48,416**	**49,407**	**52,694**	**55,692**	**58,393**
Total budget receipts	**2,153,859**	**2,285,491**	**2,415,852**	**2,590,258**	**2,714,207**	**2,878,167**	**3,034,861**
On-budget	1,576,383	1,675,526	1,773,533	1,911,129	1,997,985	2,119,705	2,233,286
Off-budget	577,476	609,965	642,319	679,129	716,222	758,462	801,575
MEMORANDUM							
Federal funds	1,310,401	1,391,759	1,481,180	1,603,674	1,677,442	1,783,065	1,878,730
Trust funds	546,513	620,753	672,520	699,346	727,925	761,693	805,257
Interfund transactions	–280,531	–336,986	–380,167	–391,891	–407,382	–425,053	–450,701
Total on-budget	**1,576,383**	**1,675,526**	**1,773,533**	**1,911,129**	**1,997,985**	**2,119,705**	**2,233,286**
Off-budget (trust funds)	**577,476**	**609,965**	**642,319**	**679,129**	**716,222**	**758,462**	**801,575**
Total	**2,153,859**	**2,285,491**	**2,415,852**	**2,590,258**	**2,714,207**	**2,878,167**	**3,034,861**

[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.