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 is 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 next Chapter.

Total receipts in 2008 are estimated to be $2,662.5 billion, an increase of $122.4 billion or 4.8 percent relative to 2007. Receipts are projected to grow at an average annual rate of 5.6 percent between 2008 and 2012, rising to $3,307.3 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 Gross Domestic Product (GDP), receipts are projected to decline from 18.5 percent in 2007 to 18.3 percent in 2008, and to rise to 18.6 percent in 2012.

Table 17–1. RECEIPTS BY SOURCE—SUMMARY

(In billions of dollars)

	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Individual income taxes	1,043.9	1,168.8	1,246.6	1,331.1	1,428.3	1,517.3	1,636.6
Corporation income taxes	353.9	342.1	314.9	319.8	325.5	340.6	366.6
Social insurance and retirement receipts	837.8	873.4	927.2	974.2	1,029.3	1,085.7	1,138.8
(On-budget)	(229.4)	(239.2)	(253.1)	(262.8)	(276.0)	(289.9)	(303.4)
(Off-budget)	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Excise taxes	74.0	57.1	68.1	63.1	63.6	68.6	71.3
Estate and gift taxes	27.9	25.3	25.7	27.4	21.7	1.7	0.5
Customs duties	24.8	26.8	29.2	30.7	32.7	34.3	35.7
Miscellaneous receipts	45.0	46.7	50.7	52.0	53.6	55.5	57.8
Total receipts	2,407.3	2,540.1	2,662.5	2,798.3	2,954.7	3,103.6	3,307.3
(On-budget)	(1,798.9)	(1,906.0)	(1,988.4)	(2,086.9)	(2,201.4)	(2,307.8)	(2,472.0)
(Off-budget)	(608.4)	(634.1)	(674.1)	(711.4)	(753.3)	(795.8)	(835.3)
Total receipts as a percentage of GDP	18.4	18.5	18.3	18.3	18.3	18.3	18.6

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

(In billions of dollars)

	Estimate				
	2008	2009	2010	2011	2012
Social security (OASDI) taxable earnings base increases:					
$97,500 to $102,600 on Jan. 1, 2008	2.7	7.0	7.9	8.8	9.7
$102,600 to $107,700 on Jan. 1, 2009	....	2.7	7.0	7.9	8.8
$107,700 to $113,100 on Jan. 1, 2010	....	....	2.8	7.4	8.3
$113,100 to $118,500 on Jan. 1, 2011	....	....	....	2.8	7.5
$118,500 to $123,600 on Jan. 1, 2012	....	....	....	....	2.7

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28, and 25 percent								Rates revert 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, lowest bracket reverts to 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 reverts 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 reverts to 167 percent of standard deduction for single filers
Child Credit	Tax credit for each qualifying child under age 17 increased to $1,000 and refundability extended to families with 1 or 2 children								Tax credit for each qualifying child under age 17 reverts to $500 and refundability restricted to taxpayers with 3 or more children
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 reverts to 60 percent Exempt amount reverts 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 reverts to $25,000, reduced by amount qualifying property exceeds $200,000 and amounts not inflation-indexed Does not apply to software	

Chart 17–1. Major Provisions of the Tax Code Under the 2001, 2003, 2004, and 2006 Enacted Tax Relief—Continued

Provision	2003	2004	2005	2006	2007	2008	2009	2010	2011
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 reverts to 10/20 percent (8/18 percent on assets held over 5 years)
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 increased to $42,500/$62,550 for single /joint filers	AMT exemption amount reverts to $33,750/$45,000 for single /joint filers				

ENACTED LEGISLATION

Several laws were enacted in 2006 that have an effect on governmental receipts. The major legislative changes affecting receipts are described below.

TAX INCREASE PREVENTION AND RECONCILIATION ACT OF 2005

The Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), which was signed by President Bush on May 17, 2006, extended previously enacted tax cuts that helped spur investment and economic expansion, resulting in more jobs and higher wages for American workers. The provisions of this Act increased the Alternative Minimum Tax (AMT) exemption amount for 2006; temporarily extended increased expensing limits for small businesses; reduced tax rates on capital gains and dividends; and made other miscellaneous changes to tax law. The major provisions of this Act are described below.

Expiring Provisions

Extend increased expensing for small business.—Under prior law, business taxpayers were 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 beginning in 2003 through 2007. The maximum amount that could be expensed was reduced by the amount by which the taxpayer's cost of qualifying property exceeded $400,000. Both the deduction and annual investment limits were 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 were permitted to make or revoke expensing elections on amended returns without the consent of the Internal Revenue Service (IRS) Commissioner. This Act extended each of these temporary provisions, applicable for qualifying property (including off-the-shelf computer software) placed in service in taxable years beginning in 2008 and 2009.

Extend reductions in individual income taxes on capital gains and dividends.—Under prior law, the maximum individual income tax rate on net capital gains and dividends was 15 percent for taxpayers in individual income tax rate brackets above 15 percent and 5 percent (zero in 2008) for lower income taxpayers. This Act extended these reduced rates (15 percent and zero), which were scheduled to expire on December 31, 2008, through December 31, 2010.

Extend and modify exceptions provided under Subpart F.—Under the Subpart F rules, certain U.S. shareholders of a controlled foreign corporation (CFC) are subject to U.S. tax currently on certain income earned by the CFC, whether or not such income is distributed to the shareholders. The income subject to current inclusion under the Subpart F rules includes, among other things, "foreign personal holding company income" and insurance income. Foreign personal holding company income generally includes many types of income derived by a financial service company, such as dividends; interest; royalties; rents; annuities; net gains from the sale of certain property, including securities, commodities and foreign currency; and income from notional principal contracts and securities lending activities. Under prior law, for taxable years beginning before January 1, 2007, certain income derived in the active conduct of a banking, financing, insurance, or similar business was provided an exception from Subpart F. This Act extended the exception for two years, to apply to taxable years beginning before January 1, 2009. This Act also provided an exception from Subpart F for dividends, interest, rents, and royalties received by one CFC from a related CFC to the extent attributable or properly allocable to non-Subpart F income of the payor, effective for taxable years beginning after December 31, 2005 and before January 1, 2009.

Estimated Tax Payments by Corporations

Modify the timing of estimated tax payments by corporations.—Corporations generally are required to pay their income tax liability in quarterly estimated payments. For corporations that keep their accounts on a calendar year basis, these payments are due on or before April 15, June 15, September 15, and December 15 (if these dates fall on a holiday or weekend, payment is due on the next business day). This Act increased the estimated tax payments due in July through September by corporations with assets of at least $1 billion to: 105 percent of the amount otherwise due in 2006, 106.25 percent of the amount otherwise due in 2012, and 100.75 percent of the amount otherwise due in 2013. For corporations affected by this provision, the next required estimated tax payment is reduced accordingly. This Act also allowed corporations to delay 20.5 percent of the estimated tax payment otherwise due on September 15, 2010 until October 1, 2010, and 27.5 percent of the estimated tax payment otherwise due on September 15, 2011 until October 1, 2011.

Alternative Minimum Tax (AMT) Relief for Individuals

Increase and extend AMT relief for individuals.—A temporary provision of prior law increased the AMT exemption amounts to $40,250 for single taxpayers, $58,000 for married taxpayers filing a joint return and surviving spouses, and $29,000 for married taxpayers filing a separate return and estates and trusts. These temporary increases were effective for taxable years beginning after December 31, 2002 and before January 1, 2006. This Act increased the AMT exemption amounts, effective for taxable years beginning after December 31, 2005 and before January 1, 2007, to $42,500 for single taxpayers, $62,550 for married taxpayers filing a joint return and surviving spouses, and $31,275 for married taxpayers filing a separate return and estates and trusts.

Under a temporary provision of prior law, taxpayers were permitted to offset both the regular tax and the AMT with nonrefundable personal tax credits, effective for taxable years beginning before January 1, 2006. This Act extended minimum tax relief for nonrefundable personal tax credits for one year, to apply to taxable year 2006. The extension does not apply to the child credit, the new saver's credit, the earned income credit (EITC) 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.

Offsets

Repeal income limitations on Roth Individual Retirement Account (IRA) conversions.—Under prior law, taxpayers with adjusted gross income (AGI) of less than $100,000 were eligible to roll over or convert all or a portion of a traditional IRA to a Roth IRA. Amounts converted were treated as distributions for income tax purposes, but the 10-percent tax on early withdrawals did not apply. This Act repealed the income limitation on conversions from traditional IRAs to Roth IRAs, effective for conversions occurring after December 31, 2009. Unless a taxpayer elects otherwise (or converted amounts are distributed before 2012), none of the amount converted in 2010 will be included in gross income for that year; instead, half of the amount converted will be included in gross income in each year, 2011 and 2012. If converted amounts are distributed before 2012, the amount included in income in the year of the distribution is increased by the amount distributed, and the amount included in income in 2012 (or 2011 and 2012 if the distribution was made in 2010) is the lesser of: (1) half of the amount includible in income as a result of the conversion, and (2) the remaining portion of such amount not already included in income.

Repeal foreign sales corporation (FSC)/extraterritorial income (ETI) binding contract relief.—The FSC Repeal and ETI Exclusion Act of 2000 replaced the FSC tax provisions of prior law, which the World Trade Organization (WTO) had found to be a prohibited export subsidy in violation of international tax standards, with an exclusion from U.S. tax for extraterritorial income. Transition rules delayed the repeal of the FSC rules and the effective date of ETI for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 30, 2000 and at all other times thereafter. The ETI provisions also were declared a prohibited export subsidy by the WTO and were repealed by the American Jobs Creation Act of 2004, effective for transactions after December 31, 2004. Certain transitional tax rules applied to transactions occurring in 2005 and 2006, providing taxpayers with 80 percent and 60 percent, respectively, of the tax benefits that would have been otherwise allowed under the prior law ETI provisions. Moreover, the ETI provisions of prior law remained in effect for transactions in the ordinary course of a trade or business if such transactions were pursuant to a binding contract between the taxpayer and an unrelated person and the contract was in effect on September 17, 2003 and at all times thereafter. Both the FSC and ETI binding contract relief of prior law were repealed under this Act, effective for taxable years beginning after May 17, 2006.

Impose withholding on certain payments made by government entities.—This Act imposed withholding on certain payments made by government entities (the Government of the United States, every State, and every political subdivision or instrumentality thereof, including multi-State agencies) to persons providing property or services. The requirement applies regardless of whether the government entity making the payment is the recipient of the property or service. The rate of withholding is three percent and applies to payments made after December 31, 2010. Political subdivisions of States (or any instrumentality thereof) with less than $100 million of annual expenditures for property or services are exempt from the withholding requirement. In addition, the provision does not apply to: (1) payments made through a public assistance or public welfare program for which eligibility is determined by a needs or income test; (2) payments, such as wages, that were subject to mandatory or voluntary withholding under prior law; (3) payments of interest; (4) payments for real property; (5) payments to tax-exempt entities or foreign governments; (6) intra-governmental payments; (7) payments made pursuant to a classified or confidential contract; and (8) payments to government employees that are not otherwise excludable from the new withholding provision with respect to the employees' services as an employee.

Modify taxation of citizens living abroad.—U.S. citizens who earn income in a foreign country may be taxed on that income by the foreign country. Such individuals are allowed a credit against the U.S. income tax imposed on foreign-source income for foreign taxes paid on that income; the amount of the credit generally is limited to the amount of U.S. tax otherwise owed on that income.

A U.S. citizen or resident living abroad may be eligible to exclude from U.S. taxable income certain foreign earned income and foreign housing costs, regardless of whether any foreign tax is paid on the foreign earned income or housing costs. To qualify for these exclusions, the taxpayer must have his or her tax home in a foreign country and must be either: (1) a U.S. citizen who is a bona fide resident of a foreign country or countries for an uninterrupted period that includes an entire taxable year, or (2) a U.S. citizen or resident present in a foreign country or countries for at least 330 full days in any 12-consecutive-month period.

The foreign earned income exclusion generally is available for a qualified individual's non-U.S. source earned income attributable to personal services performed by that individual during the period of foreign residence or presence. Under prior law, the maximum amount of the foreign earned income exclusion was $80,000 in taxable years 2002 through 2007 and was indexed annually for inflation beginning in taxable year 2008. This Act accelerated the annual indexation of the maximum amount of the foreign earned income exclusion by two years, increasing the limitation for taxable year 2006 to $82,400.

The housing cost exclusion (or deduction for purposes of computing AGI, if the otherwise excludable housing costs are not paid or reimbursed by a taxpayer's employer) is equal to the excess of a taxpayer's "housing expenses" over a base housing amount. "Housing expenses" are the reasonable expenses paid or incurred during the taxable year for housing in a foreign country for the taxpayer, and, if they live with the taxpayer, the taxpayer's spouse and dependents. Housing expenses include costs attributable to housing, such as utilities and insurance, but do not include items that are separately deductible, such as mortgage interest and real estate taxes. If the taxpayer maintains a second household outside the United States for a spouse or dependents who do not reside with the taxpayer because of dangerous, unhealthful, or otherwise adverse living conditions, the housing expenses of the second household also are eligible for exclusion. Under prior law, the base housing amount above which costs were eligible for exclusion in a taxable year was 16 percent of the annual salary (computed on a daily basis) of a GS–14 step 1 Federal employee, multiplied by the number of days of foreign residence or presence in the taxable year. This Act modified the base housing amount used in calculating the foreign housing cost exclusion, effective for taxable years beginning after December 31, 2005, changing it to 16 percent of the maximum amount (computed on a daily basis) of the foreign earned income exclusion, multiplied by the number of days of foreign residence or presence in the taxable year. Reasonable housing expenses in excess of the base housing amount may still be excluded from gross income (or, if paid by the taxpayer, deductible in computing AGI), but the amount of the exclusion is limited to 30 percent of the taxpayer's foreign earned income exclusion. Under this Act, the Secretary of the Treasury has authority to adjust this 30-percent limitation upwards or downwards, based on geographic differences in housing costs relative to housing costs in the United States.

As provided under prior law, the combined foreign earned income exclusion and housing cost exclusion (including the amount deductible in computing AGI) may not exceed the taxpayer's total foreign earned income for the taxable year. Similarly, the taxpayer's foreign tax credit must be reduced by the amount of the credit attributable to excluded income.

Under prior law, a taxpayer eligible for the foreign earned income and housing cost exclusions was subject to tax on income in excess of the exclusion amounts (after deductions), starting in the lowest tax rate bracket. Under this Act, effective for taxable years beginning after December 31, 2005, a taxpayer eligible for the foreign earned income and housing exclusions is subject to tax on income in excess of the exclusion amounts at the income tax rates that would have been applicable had the individual not elected to take the exclusions.

Require partial payment with submission of offers-in-compromise.—Offers-in-compromise are offers to the IRS by a taxpayer to settle outstanding tax liability for less than the full amount due, generally based on doubt as to liability for, or collectibility of, the tax. There are two general categories of offers-in-compromise: (1) lump-sum offers, in which the taxpayer proposes to make one lump-sum payment of a specified dollar amount in settlement of the outstanding tax liability, and (2) periodic-payment offers, in which the taxpayer proposes to make a series of payments over time in settlement of the outstanding tax liability. The IRS imposes a user fee of $150 on most offers-in-compromise, payable upon submission of the offer to the IRS. Enforcement action generally is suspended during the period that the IRS evaluates an offer. Under prior law, taxpayers were permitted (but not required) to make a deposit with their offer; if the offer was rejected, the deposit generally was returned to the taxpayer. This Act made the following changes, effective with respect to offers-in-compromise submitted to the IRS on and after July 16, 2006: (1) Taxpayers making lump-sum offers (offers to pay in five or fewer installments) are required to make a down payment of 20 percent of the amount of the offer upon submission of the offer to the IRS. (2) Taxpayers making periodic-payment offers are required to comply with the payment schedule proposed in the offer while the offer is being considered. (3) Offers submitted to the IRS that do not comply with these payment requirements are returned to the taxpayer as unprocessable and immediate enforcement action is permitted. (4) The $150 user fee is applied to the taxpayer's outstanding tax liability. (5) An offer-in-compromise is deemed accepted if the IRS does not make a decision with respect to the offer within two years from the date the offer was submitted. (6) The Secretary of the Treasury is authorized to issue regulations providing exceptions to the partial payment requirements in the case of offers from certain low-income taxpayers and offers based on doubt as to liability.

Modify 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. Under prior law, 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, could be amortized over two years. This Act increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more.

Modify taxation of unearned income of minors.—An unmarried individual eligible to be claimed as a dependent on another taxpayer's individual income tax return generally must file an individual income tax return if he or she has: (1) earned income only over $5,150 (for 2006); (2) unearned income only over the minimum standard deduction amount for dependents ($850 in 2006); or (3) both earned income and unearned income totaling more than the smaller of (a) $5,150 (for 2006) or (b) the larger of (i) $850 (for 2006) or (ii) earned income plus $300. Under prior law, unearned income of a child was taxed under special rules if: (1) the child had not reached the age of 14 by the close of the taxable year, (2) the child's unearned income (income other than wages, salaries, professional fees, or other amounts received as compensation for personal services actually rendered) was more than $1,700 (for 2006), and (3) the child was required to file a return for the year. These special rules (referred to as the "kiddie tax") applied if the child could have been claimed as a dependent on the parent's return, regardless of whether the parent actually claimed the child as a dependent. Under the kiddie tax, the child's net unearned income over $1,700 (for 2006) was taxed at the parent's tax rate if that rate was higher than the child's rate. The remainder of a child's taxable income was taxed at the child's tax rate, regardless of whether the kiddie tax applied. Effective for taxable years beginning after December 31, 2005, this Act increased the age to which the kiddie tax applies from under 14 years of age to under 18 years of age.

Provide other offsets.—Other offsets provided in this Act included: (1) application of earnings stripping rules to partners that are C corporations, (2) amendment of information reporting requirements to include interest paid on tax-exempt bonds, (3) modification of the scope of the application of the Foreign Investment in Real Property Tax Act of 1980 regime, (4) denial of tax-free treatment to certain corporate spin-off transactions, (5) imposition of new requirements on pooled financing bonds, (6) clarification of the domestic manufacturing deduction wage limitation, and (7) imposition of penalties on certain exempt entities for participation in prohibited tax shelter transactions as accommodation parties.

Other Provisions

Provide other changes.—Other changes provided in this Act included: (1) modification of the tax treatment of income earned by certain environmental cleanup funds, (2) modification of the rules relating to taxation of distributions of stock and securities of a controlled corporation, (3) expansion of eligibility for the qualified veterans' mortgage bond program, (4) treatment of the sale or exchange of certain self-created musical works as capital gains, (5) modification of the vessel tonnage tax, (6) extension of the exemption for a portion of the Permanent University Fund from the tax-exempt bond arbitrage rules, (7) election of five-year amortization for the costs of creating or acquiring a musical composition, (8) acceleration of the increased capital expenditure limitation on the issuance of qualified small issue tax-exempt bonds to apply to bonds issued after December 31, 2006, and (9) modification of the tax treatment of loans to qualified continuing care facilities.

PENSION PROTECTION ACT OF 2006

The Pension Protection Act of 2006, which was signed by President Bush on August 17, 2006, was the most sweeping reform of America's pension system enacted in 30 years. The provisions of this Act strengthened the private retirement system by making it more difficult for employers to underfund their pension plans and by preventing employers with underfunded plans from making promises to their employees that they cannot keep. Provisions of this Act also provided more incentives to individuals to save for retirement, modified tax provisions related to spending for health care, temporarily suspended certain customs duties, provided incentives for certain charitable contributions, and modified certain rules relating to activities of tax-exempt organizations. The major provisions of this Act that affect receipts are described below.

Pension Funding Rules

Reform funding rules for single-employer defined-benefit pension plans.—Under prior law, defined-benefit pension plans were 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 excluded such contributions from gross income and allowed 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 were determined under a series of complex rules and measures of assets and liability, many of which were manipulable and none of which entailed the use of an accurate measure of the plan's assets and its true liabilities. This Act replaced the funding rules of prior law, effective for plan years beginning after December 31, 2007, with a minimum funding requirement of 100 percent of plan liabilities, phased in over four years, as follows: 92 percent in 2008, 94 percent in 2009, 96 percent in 2010, and 100 percent in 2011 and subsequent years. Other funding rules provided in this Act: (1) changed the calculation of the value of credit balances and restricted the use of credit balances in lieu of cash to fund required contributions; (2) changed the method of calculating liabilities for plans considered to be at risk; (3) reduced the time period over which asset values can be averaged to two years, and limited averaged asset values to no less than 90 percent and to no more than 110 percent of current fair market value; (4) required amortization of unfunded liabilities over seven years, in most cases; (5) updated the mortality table used to project future benefits; (6) allowed plan sponsors to deduct from taxable income contributions of up to 150 percent of plan liability; and (7) modified the interest rate used to calculate pension liability, requiring the use of a yield curve based on 24-month averages of the rates on corporate bonds of relevant maturities in the top three rating categories (AAA, AA and A), phased in at 33⅓ percent in 2008, 66⅔ percent in 2009 and 100 percent beginning in 2010.

Reform funding rules for multiemployer defined-benefit plans.—Multiemployer plans are subject to the same general funding rules as the pre-2006 rules for single-employer plans, except that different rules apply in some cases. This Act modified the funding of multiemployer plans by: (1) providing additional funding rules for certain plans that are in endangered or critical status; and (2) allowing plan sponsors to deduct from taxable income contributions of up to 140 percent of plan liability. These changes were effective for plan years beginning after 2007; however, the additional funding rules for plans in endangered or critical status do no apply to plan years beginning after December 31, 2014.

Other Pension Provisions

Encourage automatic enrollment in pension plans.—Under current law, most defined-contribution plans may include a qualified cash or deferred arrangement under which employees may elect to receive cash or to have contributions made to the plan by the employer on behalf of the employee in lieu of receiving cash. Contributions made to the plan at the election of the employee are referred to as "elective deferrals." Such a plan may be designed so that the employee will receive cash unless an affirmative election to make contributions is made. Alternatively, a plan may provide that elective contributions are made at a specified rate unless the employee elects otherwise; such a plan is sometimes referred to as an "automatic enrollment" plan. In either case, the employee must have an opportunity to elect to receive cash in lieu of contributions.

This Act made changes to address employers' concerns about implementing automatic enrollment plans and to provide incentives for automatic enrollment, generally effective for plan years beginning after 2007. The changes provided in the Act: (1) exempted such plans from State payroll withholding laws; (2) provided fiduciary relief for investment of participant account balances in certain default investments; (3) provided a 90-day period from the initial payroll reduction during which participants are allowed to opt out of automatic enrollment and receive a penalty-free return of their automatic elective contributions; and (4) provided that plans with "a qualified automatic enrollment feature" satisfy the nondiscrimination rules regarding elective deferrals and employer matching contributions, and are not subject to the top-heavy rules.

Allow certain small employers to establish combined defined-benefit plans and qualified cash or deferred arrangements.—Under prior law, a defined-benefit plan could not be combined with a qualified cash or deferred arrangement (Section 401(k) plan); they had to be structured as two separate plans. This Act allowed small employers to establish combined defined-benefit and 401(k) plans, effective for plan years beginning after December 31, 2009. A small employer is an employer with an average of at least two and no more than 500 employees on business days during the preceding calendar year and at least two employees on the first day of the plan year. The assets of the combined plan must be held in a single trust and they must be clearly identified and allocated to the defined-benefit plan and the 401(k) plan to the extent necessary for the separate application of the Internal Revenue Code and ERISA; in addition, the combined plan must meet certain benefit, contribution, vesting, and nondiscrimination requirements.

Make other miscellaneous changes affecting pension plans.—Other changes in pension plans that affect receipts: (1) permitted workers in publicly held companies to divest themselves of company stock attributable to employer contributions after three years of service and prohibited employers from requiring workers to invest their own retirement savings in company stock; (2) improved portability of retirement savings, such as allowing direct rollovers from retirement plans to Roth IRAs and faster vesting of employer non-elective contributions; (3) gave taxpayers the option to deposit part of their individual income tax refund directly into an IRA; and (4) allowed members of the National Guard and reservists called to active duty to withdraw money from their IRA or pension without penalty and to repay the money within two years.

Expiring Provisions

Extend permanently IRA maximum contribution limits and index income limitations on IRA contributions.—The maximum annual contribution that can be made to a traditional or Roth IRA by or on behalf of an individual varies depending on the particular circumstances, including the individual's income. However, under prior law, the maximum annual contribution that could be made to all of an Individual's IRAs was the lesser of: (1) the individual's compensation or (2) $4,000 for taxable years 2005 through 2007, and $5,000 for taxable year 2008, indexed thereafter in increments of $500. In the case of a married couple, contributions could be made up to the dollar limit for each spouse if the combined compensation of the spouses was at least equal to the contributed amount. Individuals who attained age 50 before the end of a taxable year were allowed to make additional "catch-up" contributions. For those individuals, the otherwise maximum contribution limit was increased by $1,000 for taxable years 2006 through 2010. These contribution limits, which had been scheduled to expire after December 31, 2010, were extended permanently under this Act.

An individual may make nondeductible contributions to a traditional IRA up to the IRA contribution limits specified above (to the extent the taxpayer cannot or does not make deductible contributions). An individual may make deductible contributions to a traditional IRA up to the IRA contribution limits specified above, if neither the individual nor the individual's spouse is an active participant in an employer-sponsored retirement plan. If an individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the deduction is phased out for taxpayers with AGI above certain levels. Under prior law, the AGI phase-out ranges were: (1) $50,000 to $60,000 for single taxpayers; (2) $80,000 to $100,000 for married taxpayers filing a joint return for 2007 and subsequent years; and (3) $0 to $10,000 for married taxpayers filing a separate return. If an individual was not an active participant in an employer-sponsored retirement plan, but the individual's spouse was an active participant in such a plan, the deduction was phased out for taxpayers with AGI between $150,000 and $160,000. An individual may make nondeductible contributions to a Roth IRA subject to the IRA contribution limits specified above. However, the maximum annual contribution is phased out for taxpayers with AGI over certain levels. Under prior law, the AGI phase-out ranges were: (1) $95,000 to $110,000 for single taxpayers; (2) $150,000 to $160,000 for married taxpayers filing a joint return; and (3) $0 to $10,000 for married taxpayers filing a separate return. Under this Act, the income thresholds that determine eligibility to make IRA contributions are indexed for inflation in increments of $1,000 beginning in 2007.

Extend permanently maximum contribution and benefit limits under qualified pension plans.—Limits on contributions and benefits under qualified pension plans are based on the type of plan. Under prior law, annual contributions to a defined-contribution plan with respect to each plan participant were limited to the lesser of 100 percent of compensation or $40,000 (adjusted annually for inflation in $1,000 increments after 2002). The maximum annual benefit payable under a defined-benefit plan was generally the lesser of 100 percent of average compensation or $160,000 (adjusted annually for inflation for plans ending after

December 31, 2002, in increments of $1,000). The annual compensation of each participant that could be taken into account for purposes of determining contributions and benefits under a plan generally was limited to $200,000 in 2002 (indexed annually thereafter in $5,000 increments). The dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs was $15,000 in 2006, indexed annually thereafter in $500 increments. The dollar limit on annual elective deferrals to a SIMPLE plan was $10,000 in 2005 (adjusted for inflation in increments of $500 after 2006). The dollar limit on contributions to an eligible section 457 plan was the lesser of 100 percent of includable compensation or $15,000 in 2006, indexed annually thereafter in increments of $500. Individuals who attained age 50 before the end of a taxable year were allowed to make "catch-up" contributions to a 401(k) plan, section 403(b) annuity, SEP or SIMPLE plan, or section 457 plan. The amount of catch-up contributions permitted was the lesser of: (1) the applicable dollar amount or (2) the participant's compensation for the year after reduction by any other elective deferrals of the participant for the year. The applicable dollar amount under a 401(k) plan, section 403(b) annuity, SEP or section 457 plan was $5,000 for 2006, indexed annually thereafter in increments of $500. The applicable dollar amount under a SIMPLE plan was $2,500 in 2006, indexed annually thereafter in increments of $500. These contribution and benefit limits, which were scheduled to expire after December 31, 2010, were extended permanently under this Act.

Extend permanently the ability to make tax-free distributions from qualified tuition programs (section 529 of the Internal Revenue Code).—Qualified State tuition programs generally take two forms—prepaid tuition plans and savings plans. Under a prepaid tuition plan, an individual may purchase tuition credits or certificates on behalf of a designated beneficiary, which entitle the beneficiary to the waiver or payment of qualified higher education expenses at participating educational institutions. Under a savings plan, an individual may make contributions to an account established for the purpose of meeting the qualified higher education expenses of a designated beneficiary. Private educational institutions are also allowed to establish qualified prepaid tuition plans (but not savings plans), provided the institution is eligible to participate in Federal financial aid programs under Title IV of the Higher Education Act of 1965. Earnings in a qualified savings program accumulate tax free. Under current law, if a distribution is used to pay qualified higher education expenses, the distribution is tax free. Qualified expenses include: tuition and fees; certain expenses for room and board; certain expenses for books, supplies and equipment; and expenses for a special needs beneficiary that are necessary in connection with enrollment or attendance at an eligible education institution. This Act permanently extended the preferred tax treatment of the distributions, which was scheduled to expire with respect to withdrawals after December 31, 2010. This Act also granted broad authority to the Secretary of the Treasury to issue regulations to carry out the purposes of section 529 and to prevent abuse of those purposes.

Extend permanently the nonrefundable tax credit (saver's credit) for certain elective deferrals and IRA contributions.—Under prior law, effective for taxable years beginning after December 31, 2001 and before January 1, 2007, a nonrefundable tax credit was provided for up to $2,000 in contributions made by eligible taxpayers to a qualified plan or to a traditional or Roth IRA. The credit, which was in addition to any deduction or exclusion that would otherwise apply with respect to the contribution, was available to single taxpayers with AGI less than or equal to $25,000 ($37,500 for heads of household and $50,000 for married taxpayers filing a joint return). The credit was available to individuals who were 18 years of age or older (other than individuals who were full-time students or claimed as a dependent on another taxpayer's return) and was offset against both the regular and alternative minimum tax. The credit rate was 50 percent for single taxpayers with AGI less than or equal to $15,000 ($30,000 for married taxpayers filing a joint return and $22,500 for heads of household), 20 percent for single taxpayers with AGI between $15,000 and $16,250 (between $30,000 and $32,500 for married taxpayers filing a joint return and between $22,500 and $24,375 for heads of household), and 10 percent for single taxpayers with AGI between $16,250 and $25,000 (between $32,500 and $50,000 for married taxpayers filing a joint return and between $24,375 and $37,500 for heads of household). The saver's credit was extended permanently under this Act. In addition, this Act provided for annual indexing of the income limits applicable to the credit in increments of $500 beginning in 2007.

Health and Medical Benefits

Modify tax treatment of annuity and life insurance contracts with a long-term care insurance feature.—Under prior law, annuity contracts were not allowed to have a qualified long-term care insurance feature; however, long-term care insurance could be provided by a rider on or as a part of a life insurance contract. This Act allowed qualified long-term care insurance to be provided by a rider on or as a part of an annuity contract and provided special tax treatment for the long-term care component of a life insurance or annuity contract. Under this Act: (1) payments for a qualified long-term care insurance contract, which is a rider on or is part of a life insurance contract or annuity contract, that are charged against the cash value of the annuity contract or the cash surrender value of the life insurance contract are not includable in income and the investment in the contract is reduced (but not below zero) by the charge; (2) the rules for tax-free exchanges of certain insurance contracts are expanded to include exchanges of a life insurance contract, an endowment contract, an annuity contract, or a qualified long-term care insurance contract for a qualified long-term care insurance contract; and (3) except as otherwise provided in regulations, the portion of an annuity or life insurance contract providing long-term care insurance coverage is treated as a separate contract for Federal tax purposes. These, and other rules concerning the taxation of long-term care insurance provided as a rider on or as part of an annuity or life insurance contract generally will be effective for taxable years beginning after December 31, 2009 for contracts issued after December 31, 1996.

Permit tax-free distributions from governmental retirement plans for premiums for health and long-term care insurance for public safety officers.—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 IRA generally is included in the taxpayer's gross income in the year of distribution, except to the extent the amount received constitutes a return of after-tax contributions or a qualified distribution from a Roth IRA. This Act provided an annual exclusion from gross income for up to $3,000 in otherwise taxable distributions from an eligible retirement plan of a qualified public safety officer for the payment of qualified health insurance premiums made directly to the insurer. Eligible retired public safety officers are individuals who, by reason of disability or attainment of normal retirement age, are separated from service with the employer who maintains the eligible retirement plan from which pension benefits are received. Qualified health insurance premiums include premiums for accident or health insurance or qualified long-term care insurance contracts covering the taxpayer and the taxpayer's spouse and dependents. Amounts excluded from income are not taken into account in determining the itemized deduction for medical expenses or the deduction for health insurance of self-employed individuals. The provision is effective for distributions in taxable years beginning after December 31, 2006.

Charitable Contributions and Tax-Exempt Organizations

Permit tax-free withdrawals from IRAs for charitable contributions.—Eligible individuals may make deductible or non-deductible contributions to a traditional IRA and nondeductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included in gross income to the extent attributable to earnings. This Act provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed $100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

Expand 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, or, if less, the fair market value of 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.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. This Act extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayers other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business.

Modify basis adjustment to stock of S corporations contributing appreciated property.—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under this Act, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1, 2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property.

Make other changes affecting charitable contributions and tax-exempt organizations.—Other incentives for charitable contributions or modifications in the tax treatment of tax-exempt organizations provided in this Act included: (1) extension of the enhanced deduction for contributions of books to public schools for two years; (2) modification of the tax treatment of certain payments to controlling exempt organizations; (3) modification of the deduction for qualified conservation contributions; (4) modification of the deduction for charitable contributions of clothing and household items that are not in good condition and for items of minimal monetary value; (5) expansion of the definition of gross investment income of private foundations; (6) increases in penalty excise taxes applicable to certain activities of charities, social welfare organizations, and private foundations; (7) modification of recordkeeping and substantiation requirements; and (8) provision of new rules governing donor advised funds and supporting organizations.

TAX RELIEF AND HEALTH CARE ACT OF 2006

The Tax Relief and Health Care Act of 2006, which was signed by President Bush on December 20, 2006, extended a number of expired or expiring tax provisions, modified health savings accounts, modified various trade measures, and made a number of other changes to tax law. This Act also authorized drilling for oil in the Gulf of Mexico, rolled back a cut in Medicare physician payments, and amended the Surface Mining Control and Reclamation Act. The major provisions of this Act that affect receipts are described below.

Expiring Provisions

Extend deduction for qualified tuition and related expenses.—An above-the-line deduction of up to $4,000 is provided for qualified higher education expenses paid by a qualified taxpayer during the taxable year. For a given taxable year, the deduction may not be claimed if an education tax credit is claimed for the same student. In addition, the deduction may not be claimed for amounts taken into account in determining the amount excludable from income due to a distribution from a Coverdell education IRA or the amount of interest excludable from income with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however, the deduction may be claimed for the amount of a distribution from a qualified tuition plan that is not attributable to earnings. This Act extended the deduction, which had expired with respect to expenses incurred in taxable years beginning after December 31, 2005, to apply to expenses incurred in taxable years beginning before January 1, 2008.

Extend and modify the new markets tax credit.—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 extended the new markets tax credit through 2008 and permitted up to $3.5 billion in qualified equity investment for that calendar year. This Act also required the Secretary of the Treasury to prescribe regulations to ensure that non-metropolitan counties receive a proportional allocation of qualified equity investments.

Extend optional deduction for State and local general sales taxes.—Under prior law, effective for taxable years beginning after December 31, 2003 and before January 1, 2006, a taxpayer was allowed to elect to take an itemized deduction for State and local general sales taxes in lieu of the itemized deduction for State and local income taxes. This Act extended this deduction for two years, effective for taxable years beginning before January 1, 2008.

Extend and modify the research and experimentation (R&E) tax credit.—The 20-percent tax credit for qualified research and experimentation expenditures above a base amount and the alternative incremental credit expired with respect to expenditures incurred after December 31, 2005. This Act: (1) extended the research credit for two years, to apply to expenditures incurred before January 1, 2008; (2) extended the alternative incremental credit for one year, without modification, to apply to expenditures incurred before January 1, 2007; and (3) modified the alternative incremental credit and established an alternative simplified credit, to apply to expenditures incurred after December 31, 2006 and before January 1, 2008.

Extend and modify the work opportunity tax credit and the welfare-to-work tax credit.—The work opportunity tax credit (WOTC) 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 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 Act extended both the WOTC and the welfare-to-work tax credit for one year without modification, effective for wages paid to qualified individuals who began work for the employer after December 31, 2005 and before January 1, 2007. For wages paid to individuals who begin work for the employer after December 31, 2006 and before January 1, 2008, this Act combined and modified the two credits. Modifications included: (1) use of the WOTC definition of wages; (2) repeal of the requirement that a qualified ex-felon be certified as a member of an economically disadvantaged family; (3) expansion of eligibility by increasing the age ceiling for the food stamp recipient category; and (4) extension of the paperwork filing deadline from 21 days to 28 days.

Extend treatment of combat pay for purposes of computing the EITC.—This Act extended for one year, through December 31, 2007, 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.

Extend and modify authority to issue Qualified Zone Academy Bonds.—State and local governments are allowed to issue "qualified zone academy bonds," the interest on which is effectively paid by the Federal government in the form of an annual income tax credit. The proceeds of the bonds must be used for teacher training, purchases of equipment, curriculum development, or rehabilitation and repairs at certain public school facilities. Under prior law, a nationwide total of $400 million of qualified zone academy bonds were authorized to be issued in each of calendar years 1998 through 2005 and unused authority could be carried forward for up to two years. This Act authorized the issuance of an additional $400 million of qualified zone academy bonds in each of calendar years 2006 and 2007. This Act also: (1) extended the arbitrage requirements that apply to interest-bearing tax-exempt bonds to qualified zone academy bonds, (2) imposed new spending requirements on the issuers of these bonds, and (3) imposed new reporting requirements on the issuers of these bonds.

Extend the above-the-line deduction for qualified out-of-pocket classroom expenses.—Taxpayers who itemize deductions (do not use the standard deduction) and incur unreimbursed, job-related expenses may deduct those expenses to the extent that when combined with other miscellaneous itemized deductions they exceed two percent of AGI. Through 2005, certain teachers and other elementary and secondary school professionals could deduct up to $250 in annual qualified out-of-pocket classroom expenses above-the-line. Expenses claimed as an above-the-line deduction could not be claimed as an itemized deduction. This Act extended this above-the-line deduction to apply to expenses incurred before January 1, 2008.

Extend and expand expensing of brownfields remediation costs.—Taxpayers may elect to treat certain environmental remediation expenditures that would otherwise be chargeable to a capital account as deductible in the year paid or incurred. This Act extended this provision, making it available for environmental remediation expenditures paid or incurred after December 31, 2005 and before January 1, 2008. In addition, this Act expanded the provision to apply to expenditures paid or incurred to abate contamination at sites contaminated by petroleum products, which include crude oil, crude oil condensates and natural gasoline.

Extend tax incentives for the District of Columbia (DC).—A one-time, nonrefundable $5,000 tax credit is available to purchasers of a principal residence in DC who have not owned a residence in DC during the year preceding the purchase. The credit phases out for taxpayers with modified AGI between $70,000 and $90,000 ($110,000 and $130,000 for joint returns). This Act extended the credit for two years, making it available with respect to purchases after December 31, 2005 and before January 1, 2008.

The DC Enterprise Zone includes the DC Enterprise Community and DC census tracts with a poverty rate of at least 20 percent. Businesses in the zone are eligible for: (1) A wage credit equal to 20 percent of the first $15,000 in annual wages paid to qualified employees who reside within DC; (2) $35,000 in increased section 179 expensing; and (3) in certain circumstances, tax-exempt bond financing. In addition, a capital gains exclusion is allowed for certain investments held more than five years and made within the DC Enterprise Zone, or within any DC census tract with a poverty rate of at least 10 percent. This Act extended the DC Enterprise Zone incentives for two years, through December 31, 2007.

Extend tax incentives for employment and investment on Indian reservations.—This Act extended for two years, through December 31, 2007, the employment tax credit for qualified workers employed on an Indian reservation and the accelerated depreciation rules for qualified property used in the active conduct of a trade or business within an Indian reservation. The employment tax credit is not available for employees involved in certain gaming activities or who work in a building that houses certain gaming activities. Similarly, property used to conduct or house certain gaming activities is not eligible for the accelerated depreciation recovery periods.

Extend modified recovery period for qualified leasehold improvements and qualified restaurant property.—A taxpayer generally must capitalize the cost of property used in a trade or business and recover such cost over time through annual deductions for depreciation or amortization. Tangible property generally is depreciated under the modified accelerated cost recovery system (MACRS). Under this system, depreciation is determined by applying specified recovery periods, placed-in-service conventions, and depreciation methods to the cost of various types of depreciable property. Depreciation allowances for improvements made on leased property are determined under MACRS, even if the recovery period assigned to the property is longer than the term of the lease. Under prior law, the recovery period for qualified leasehold improvement property and qualified restaurant property was temporarily reduced from 39 years to 15 years, effective for such property placed in service after October 22, 2004 and before January 1, 2006. This Act extended the 15-year recovery period applicable to qualified leasehold improvement property and qualified restaurant property, effective for such property placed in service before January 1, 2008.

Extend tax on failure to comply with mental health parity requirements applicable to group health plans.—Group health plans that provide both mental health benefits and medical and surgical benefits cannot impose aggregate lifetime or annual dollar limits on mental health benefits that are not imposed on substantially all medical and surgical benefits. An excise tax of $100 per day for each individual affected (during the period of noncompliance) is imposed on an employer sponsoring a group plan that fails to meet these requirements. For a given taxable year, the tax is limited to the lesser of 10 percent of the employer's group health insurance expenses for the prior taxable year or $500,000. This Act extended the mental health parity requirements and excise tax for failure to comply with these requirements, which had been scheduled to expire with respect to benefits furnished after December 31, 2006, through December 31, 2007.

Extend deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for: (1) a "qualified research contribution", or (2) a "qualified computer contribution." The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. This Act extended the enhanced deduction for a qualified computer contribution, which expired with respect to donations made after December 31, 2005, to apply to donations made before January 1, 2008. (The enhanced deduction for "qualified research contributions" does not expire.) In addition, this Act expanded the definition of property eligible for either the enhanced deduction relating to research equipment or computers to property assembled by the taxpayer; under prior law the deduction was restricted to property constructed by the taxpayer.

Extend Archer Medical Savings Accounts (Archer MSAs).—Self-employed individuals and employees of small firms are allowed to establish Archer MSAs; the number of accounts is capped at 750,000. In addition to other requirements: (1) individuals who establish Archer MSAs must be covered by a high-deductible health plan (and no other plan) with a deductible of at least $1,750 but not greater than $2,650 for policies covering a single person and a deductible of at least $3,500 but not greater than $5,250 in all other cases (these amounts are indexed annually for inflation); (2) tax-preferred contributions are limited to 65 percent of the deductible for single policies and 75 percent of the deductible for other policies; and (3) either an individual or an employer, but not both, may make a tax-preferred contribution to an Archer MSA for a particular year. Under prior law, no new contributions could be made to an Archer MSA after December 31, 2005, except for the following: (1) those made by or on behalf of individuals who previously had Archer MSA contributions and (2) those made by individuals employed by a participating employer. This Act extended the Archer MSA program for two years, through December 31, 2007.

Extend suspension of net income limitation on percentage depletion for marginal oil and gas wells.—Taxpayers are allowed to recover their investment in oil and gas wells through depletion deductions. For certain properties, deductions may be determined using the percentage of depletion method; however, in any year, the amount deducted generally may not exceed 100 percent of the net income from the property. Under prior law, for taxable years beginning after December 31, 1997 and before January 1, 2006, domestic oil and gas production from "marginal" properties was exempt from the 100-percent-of-net-income limitation. This Act extended the exemption to apply to taxable years beginning after December 31, 2005 and before January 1, 2008.

Extend economic development credit for American Samoa.—Certain domestic corporations with business operations in the U.S. possessions are eligible for the possession tax credit, which offsets the U.S. tax imposed on certain income related to operations in the U.S. possessions (including, among other places, American Samoa). The possession tax credit is available only to a corporation that qualifies as an existing credit claimant; the determination of whether a corporation is an existing credit claimant is made separately for each possession. The credit is computed separately for each possession with respect to which the corporation is an existing claimant and the credit is subject to either an economic activity-based limitation or an income-based limit. Under prior law, the possession tax credit was repealed for new claimants for taxable years beginning after December 31, 1995, and was phased out for existing credit claimants for taxable years beginning after December 31, 1995 and before December 31, 2006. This Act extended and modified the credit with respect to American Samoa. Under the provision, a domestic corporation that was an existing credit claimant with respect to American Samoa and that elected the application of the possession tax credit for its last taxable year beginning before January 1, 2006 is allowed to claim a possession tax credit based on the economic activity-based limitation rules for the first two taxable years beginning after December 31, 2005 and before January 1, 2008.

Extend placed-in-service deadline for certain Gulf Opportunity Zone 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 the Gulf Opportunity Zone Act of 2005, qualifying Gulf Opportunity Zone (GO Zone) property was provided an additional first-year depreciation deduction equal to 50 percent of the adjusted basis of the property. In order to qualify, property generally had to be tangible property with a recovery period of 20 years or less and included: (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 had to 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 had to commence with the taxpayer on or after August 28, 2005; and (3) the property had to 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). This Act extended the placed-in-service deadline to December 31, 2010 for nonresidential real property and residential rental property located in those portions of the GO Zone in a county or parish in which hurricanes occurring in 2005 damaged more than 60 percent of the housing units. However, only the adjusted basis of such property attributable to manufacture, construction, or production before January 1, 2010 ("progress expenditures") is eligible for the additional first-year depreciation.

Extend IRS authority to fund undercover operations.—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, which places it on equal footing with other Federal law enforcement agencies. These undercover operations include international and domestic money laundering and narcotics operations. This Act extended this funding authority, which expired on December 31, 2006, through December 31, 2007.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—The disclosure of tax return information relating to terrorism is permitted 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. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

Extend provisions permitting disclosure of certain other tax return information.—Certain law permits disclosure of taxpayer identity information and signatures to any agency, body, or commission of any State for the purpose of carrying out with such agency, body or commission a combined Federal and State employment tax reporting program approved by the Secretary of the Treasury. This Act extended this disclosure authority, which expired on December 31, 2006, through December 31, 2007.

Energy Provisions

Extend placed-in-service date for tax credit for energy produced from certain renewable sources.—Taxpayers are allowed a tax credit for electricity produced from wind, closed-loop biomass, open-loop biomass, geothermal energy, solar energy, small irrigation power, municipal solid waste, and qualified hydropower. The credit rate is 1.5 cents per kilowatt hour for electricity produced from wind, closed-loop biomass, geothermal, and solar power, and 0.75 cent per kilowatt hour for electricity produced from open-loop biomass, small irrigation power, municipal solid waste, and qualified hydropower (both rates are adjusted for inflation since 1992). A credit is also provided for the production of refined coal and Indian coal at qualified facilities. The credit for refined coal is $4.375 per ton (adjusted for inflation since 1992) and the credit for Indian coal is $1.50 per ton for coal produced after December 31, 2005 and before January 1, 2010 and $2.00 per ton for coal produced after December 31, 2009 and before January 1, 2013. To qualify for the credit under prior law, electricity generally had to be produced at a facility placed in service before January 1, 2008 (January 1, 2006, in the case of solar facilities) and coal had to be produced at a facility placed in service before January 1, 2009. This Act extended the placed-in-service date by one year, through December 31, 2008, for all facilities except solar energy, refined coal, and Indian coal facilities. For these facilities the placed-in-service termination dates of prior law were not changed.

Extend and modify other energy tax provisions.—Other energy tax provisions provided in this Act: (1) authorized the issuance of an additional $400 million of clean renewable energy bonds and extended the authority to issue such bonds through December 31, 2008; (2) modified the advanced coal credit with respect to sub-bituminous coal; (3) extended the deduction for expenditures associated with the installation of energy-efficient property in a commercial building; (4) extended the tax credit for the construction of qualified new energy-efficient homes to apply to homes the construction of which is substantially completed after December 31, 2005 and that are purchased after December 31, 2005 and before January 1, 2009; (5) extended the tax credit for the purchase of certain residential solar energy property to apply to property placed in service after December 31, 2005 and before January 1, 2009; and (6) extended the business energy tax credit for the cost of certain solar energy, microturbine, and fuel cell property to apply to property purchased before January 1, 2009.

Health Savings Accounts

Modify health savings accounts.—Individuals with a high-deductible health plan (and no other health plan other than a plan that provides certain permitted coverage) may establish a health savings account (HSA). Individuals who may be claimed as a dependent on another person's tax return cannot establish HSAs and individuals who enroll in Medicare cannot make contributions to an HSA. In general, HSAs provide tax-favored treatment for current medical expenses as well as the ability to save on a tax-favored basis for future medical expenses. Contributions to an HSA may be made by both an individual and the individual's employer, all contributions are aggregated for purposes of the maximum annual contribution limit, and contributions to Archer MSAs reduce the annual contribution limit for HSAs. Contributions to an HSA made by an employer are excluded from income and employment taxes and, within limits, contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual in determining AGI (whether or not the individual itemizes deductions). Earnings on amounts in an HSA are not taxable and distributions for qualified medical expenses are not included in gross income; however, distributions from an HSA that are not used for qualified medical expenses are included in gross income and except in the case of death, disability or the attainment of age 65, are subject to an additional tax of 10 percent. Under prior law, the maximum aggregate annual contribution that could be made to an HSA was the lesser of: (1) 100 percent of the annual deductible under the high deductible health plan or (2) for 2007, $2,850 in the case of self-only coverage and $5,650 in the case of family coverage. In the case of policy holders and covered spouses who were age 55 or older, the HSA annual contribution limit was greater than the otherwise applicable limit by $700 in 2006, $800 in 2007, $900 in 2008, and $1,000 in 2009 and subsequent years. This Act modified HSAs by: (1) allowing one-time rollovers of certain amounts (not greater than the balance on September 21, 2006) from flexible spending arrangements (FSAs) and health reimbursement arrangements (HRAs) directly to HSAs, effective for distributions on or after December 20, 2006 and before January 1, 2012; (2) treating certain FSA coverage as disregarded coverage for purposes of determining if tax deductible contributions can be made to an HSA, effective for taxable years beginning after December 31, 2006; (3) repealing the provision that limited the maximum deductible contribution to the annual deductible under the high-deductible health plan, effective for taxable years beginning after December 31, 2006; (4) modifying the 12-month period over which the Consumer Price Index (CPI) for a calendar year is determined for purposes of making cost-of-living adjustments to HSA contribution limits and high-deductible health plan requirements, effective for adjustments for taxable years beginning after 2007; (5) allowing individuals who become eligible individuals in a month other than January to make the full deductible HSA contribution for the year, effective for taxable years beginning after December 31, 2006; (6) modifying employer comparable contribution requirements for contributions made to non-highly compensated employees; and (7) allowing one-time rollovers from IRAs directly to HSAs up to the annual HSA maximum contribution, effective for taxable years beginning after December 31 2006.

Trade Measures

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. This Act extended this program, which was scheduled to expire after December 31, 2006, through December 31, 2008. This Act also provided that the President should revoke any existing competitive need limitation (CNL) waiver that has been in effect for at least five years, if a GSP-eligible product from a specific country has an annual trade level in the previous calendar year that exceeds 150 percent of the annual trade cap or 75 percent of all U.S. imports of that product.

Extend Andean Trade Preference Act (ATPA).—The ATPA, which was scheduled to expire after December 31, 2006, was designed to provide economic alternatives for Bolivia, Columbia, Ecuador, and Peru in their fight against narcotics production and trafficking. This Act extended the ATPA for six-months through June 30, 2007. An additional six-month extension, through December 31, 2007, was granted to any ATPA beneficiary country that concludes a trade promotion agreement with the United States, provided the Congress and that country's legislature both approve the agreement by June 30, 2007.

Modify African Growth and Opportunity Act (AGOA) and AGOA Acceleration Act.—The African Growth and Opportunity Act (AGOA) and the AGOA

Acceleration Act, enacted in 2000 and 2004, respectively, reduced barriers to trade, thereby increasing U.S.-Africa trade, creating jobs, and increasing opportunities for Africans and Americans alike. This Act modified previous AGOA legislation by: (1) extending the deadline for use of third country fabric benefits, which was scheduled to expire after September 30, 2007, through September 30, 2012, with a 3.5 percent cap; (2) providing an exception to the third country fabric benefit for apparel goods made from fabric or yarn components that are in "abundant supply" in Africa; and (3) providing duty-free treatment to certain textiles and textile articles (non-apparel) of wholly made African fabric imported from lesser-developed AGOA beneficiaries.

Other trade measures.—This Act also: (1) authorized the President to grant permanent normal trade relations status to Vietnam; (2) provided new rules of origin for duty-free apparel imports from Haiti, subject to meeting statutory criteria; (3) offered temporary duty reductions on a variety of items not manufactured in the United States; and (5) extended the period from 15 to 30 days before changes made in the Harmonized Tariff Schedule of the United States to implement certain international tariff nomenclature obligations become effective.

Other Provisions

Expand qualified mortgage bond program.—Under current law, State and local governments may issue mortgage revenue bond (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 bonds issued after December 20, 2006 and before January 1, 2008, this Act waived the first-time homebuyer requirement with respect to financing for veterans who served in the active military. The exception applies without regard to the date the veteran last served on active duty or the date on which the veteran applied for the loan after leaving active duty; however, each veteran may use the exception only one time.

Allow prepayment of premium liability for coal industry health benefits.—The United Mine Workers of America (UMWA) Combined Benefit Fund was established by the Coal Industry Retiree Health Benefit Act of 1992 to assume responsibility of payments for medical care expenses of certain retired miners and their dependents. The Combined Benefit Fund is financed by assessments on current and former signatories to labor agreements with the UMWA, past transfers from an overfunded United Mine Workers pension fund, and transfers from the Abandoned Mine Reclamation Fund. The Social Security Administration is responsible for assigning eligible retired miners and their dependents to current and former signatories to labor agreements with the UMWA and calculating annual contributions to be paid by each such signatory for each beneficiary assigned to the signatory. The term "assigned operator" is used to refer to the signatory to whom liability for a particular beneficiary of the Combined Benefit Fund has been assigned. Effective December 20, 2006, this Act allowed certain assigned operators to prepay their premium liability to the Combined Benefit Fund. Under this Act: (1) the payment by the assigned operator (or any related person on behalf of the assigned operator) must be no less than the present value of the total premium liability of the assigned operator, as determined by the operator's enrolled actuary, using actuarial methods and assumptions each of which is reasonable and which are reasonable in the aggregate; and (2) the enrolled actuary must file with the Department of Labor an actuarial report regarding the valuation made by the actuary.

Provide other changes.—Other provisions in this Act: (1) allowed U.S. businesses operating as branches in Puerto Rico to claim the domestic manufacturing deduction for two years; (2) allowed individuals to take advantage of a refundable credit with respect to certain long-term unused AMT credits existing prior to January 1, 2013; (3) allowed individuals to treat premiums paid or accrued before December 31, 2007 on qualified mortgage insurance contracts issued after January 1, 2007 as qualified mortgage interest (subject to income limits); (4) modified the excise tax on unrelated business taxable income of charitable remainder trusts; and (5) reformed the reward program for individuals who provide information regarding violations of the tax laws.

UNITED STATES-OMAN FREE TRADE AGREEMENT IMPLEMENTATION ACT

This Act, which was signed by President Bush on September 26, 2006, approved and provided for U.S implementation of the United States-Oman Free Trade Agreement, as signed by the United States and Oman on January 19, 2006. When this Agreement enters into force, it will level the playing field for U.S. workers and businesses, provide additional market access for U.S. goods, help Oman's leaders develop long-term opportunities for their people, and advance our shared goal of building a Middle East Free Trade Area. By strengthening our relations with a strategic friend and ally in the Middle East, this Agreement will also help protect America's national security interests.

ADMINISTRATION PROPOSALS

IMPROVE THE TAX SYSTEM TO MAKE THE U.S. MORE COMPETITIVE

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 tax system should promote the competitiveness of American workers and businesses in the global economy. The Report of the President's Advisory Panel on Federal Tax Reform has helped lay groundwork on ways to ensure that our tax system better meets the needs of today's economy.

The President's tax relief enacted in 2001 and 2003 helped move the tax code in this direction. The President has proposed changes that would move the tax code yet further in this direction. The Budget includes proposals to make health care more affordable and consumer-driven, to promote savings for all Americans, and to encourage investment by entrepreneurs. The Budget also recognizes that tax policy analysis needs to account fully for the economic benefits of policy changes on our economy. In the coming months, the Treasury Department will engage in a public dialogue on how our tax system can be improved to make the U.S. more competitive in the global economy.

MAKE PERMANENT CERTAIN TAX RELIEF 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, 2009 and 2010) 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, 2010.

Extend permanently increased expensing for small business.—Under current law, beginning in 2010, taxpayers may expense up to $25,000 in annual investment expenditures for qualifying property, and the maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $200,000. Neither of these dollar amounts is indexed for inflation. However, under temporary provisions first enacted in 2003, 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 beginning in 2003 through 2009. The maximum amount that may be expensed is reduced by the amount by which the taxpayer's cost of qualifying property exceeds $400,000. Both the temporary deduction and annual investment limits are indexed annually for inflation, effective for taxable years beginning after 2003 and before 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, 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 2009.

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

The Administration proposes to replace current law IRAs with two new savings accounts: a Lifetime Savings Account (LSA) and a Retirement Savings Account (RSA). Regardless of age or income, individuals could make annual nondeductible contributions of $2,000 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 any time 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, 2007 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 before January 1, 2009 could spread the included conversion amount over four 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, 2007.

Encourage Entrepreneurship and Investment

Increase expensing for small business.—Business taxpayers are currently 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 beginning in 2003 through 2009. The maximum 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 2010. Also, with respect to a taxable year beginning after 2002 and before 2010, 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 2007. These higher amounts would be indexed for inflation, effective for taxable years beginning after 2008.

Invest in Health Care

Provide a flat $15,000 deduction for family coverage ($7,500 for individual coverage) for those with and who purchase health insurance.—The Administration proposes to provide a flat $15,000 deduction to all families who purchase health insurance ($7,500 for those purchasing individual coverage), whether directly or through an employer, that meets minimum requirements. The full deduction would apply regardless of how much a family or individual spends on health insurance; that is, a family or individual that spends less than the full deduction on health insurance would still receive the full deduction. The deduction would apply for purposes of both the income and payroll tax.

The new, flat deduction would replace the existing exclusion for employer-provided health insurance, the self-employed premium deduction, and the medical itemized deduction for those under 65 years of age. The current exclusion or deduction from income of health care spending, whether for insurance premiums or out-of-pocket expenses, except under a Health Savings Account (HSA), would also be repealed. Employers would be required to report the value of health insurance coverage to their employees on their annual Form W-2 and such amounts would be subject to withholding and employment taxes. Businesses would continue to deduct employer-provided health insurance as a business expense. In addition, the phase-out rate for the EITC for taxpayers with qualifying children would be reduced to 15 percent. These provisions would be effective for tax years beginning after December 31, 2008.

Expand and make health savings accounts (HSAs) more flexible.—Current law allows individuals to accumulate funds in an 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, individual contributions to HSAs are deductible for income tax purposes, while employer contributions to HSAs are excluded from both the income and payroll tax. The higher deductible under HSA-qualified health plans increases the cost consciousness of health care consumers by increasing their exposure to the cost of health care.

In addition to higher deductibles, the Administration also recognizes that higher coinsurance levels encourage cost consciousness among health care consumers. Therefore, the Administration proposes to allow health plans to be considered HSA-eligible if they meet all the existing requirements of an HDHP except that, in lieu of satisfying the minimum deductible requirement, they have at least a 50 percent coinsurance requirement and a minimum out-of-pocket exposure that would result in the same (or lower) premium as coverage under a high-deductible health plan under the current requirements for the same family or individual.

The Administration also proposes that additional changes be made to HSAs to encourage the use of HSAs and coverage under the HSA-eligible high-deductible health plans including: (1) allowing family coverage to include coverage where each individual in the family can receive benefits once they have reached the minimum deductible for an individual HDHP; (2) allowing both spouses to contribute the catch-up contribution to a single HSA owned by one spouse if both spouses are eligible individuals; (3) allowing an individual to be covered by a flexible spending arrangement (FSA) or health reimbursement arrangement (HRA) with first dollar coverage and still contribute to an HSA, but offset the maximum allowable HSA contribution by the level of FSA or HRA coverage; (4) 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; and (5) 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, 2007.

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 Trade Adjustment Assistance (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, 2007. 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, 2007.

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 pre-designation expenses.—Current law provides a 50-percent credit for expenses related to human clinical testing of drugs for the treatment of certain rare diseases and conditions ("orphan drugs"). A taxpayer may claim the credit only for expenses incurred after the Food and Drug Administration (FDA) designates a drug as a potential treatment for a rare disease or condition. This creates an incentive to defer clinical testing for orphan drugs until the taxpayer receives the FDA's approval and increases complexity for taxpayers by treating pre-designation and post-designation clinical expenses differently. The Administration proposes to allow taxpayers to claim the orphan drug credit for expenses incurred prior to FDA designation if designation occurs before the due date (including extensions) for filing the tax return for the year in which the FDA application was filed. The proposal would be effective for qualified expenses incurred after December 31, 2006.

Provide Incentives for Charitable Giving

Extend permanently tax-free withdrawals from IRAs for charitable contributions.—Under current law, eligible individuals may make deductible or non-deductible contributions to a traditional IRA and non-deductible contributions to a Roth IRA. Pre-tax contributions and earnings in a traditional IRA are included in income when withdrawn. Qualified withdrawals from a Roth IRA are excluded from gross income; withdrawals that are not qualified are included in gross income to the extent attributable to earnings. The Pension Protection Act of 2006 provided an exclusion from gross income for otherwise taxable distributions from a traditional or a Roth IRA made directly to a qualified charitable organization. The exclusion may not exceed $100,000 per taxpayer per taxable year, is applicable only to distributions made on or after the date the IRA owner attains age 70½, and is effective for distributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. The exclusion applies only if a charitable contribution deduction for the entire distribution would otherwise be allowable under current law, determined without regard to the percentage-of-AGI limitation. No charitable deduction is allowed with respect to any amount excludable from income under this provision.

The Administration proposes to permanently extend this exclusion, effective for distributions made in taxable years beginning after December 31, 2007.

Extend permanently 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, or, if less, the fair market value of 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.

The Katrina Emergency Tax Relief Act of 2005 expanded the enhanced deduction to apply to qualified contributions of food inventory made after August 27, 2005 and before January 1, 2006 by all taxpayers (not just C corporations) engaged in a trade or business. The Pension Protection Act of 2006 extended the enhanced charitable deduction for contributions of food inventory provided under the Katrina Emergency Tax Relief Act of 2005 to apply to contributions made after December 31, 2005 and before January 1, 2008. The donated food must meet certain quality and labeling standards, and, for taxpayer's other than C corporations, the total deduction for donated food inventory may not exceed 10 percent of the taxpayer's net income from the related trade or business. The Administration proposes to permanently extend the enhanced charitable deduction for contributions of food inventory to apply to contributions made after December 31, 2007.

Extend permanently the deduction for corporate donations of computer technology.—The charitable contribution deduction that may be claimed by corporations for donations of inventory property generally is limited to the lesser of fair market value or the corporation's basis in the property. However, corporations are provided enhanced deductions, not subject to this limitation, for contributions of computer technology and equipment for education purposes. The enhanced deduction is equal to the lesser of: (1) basis plus one-half of the item's fair market value in excess of basis, or (2) two times basis. To qualify for the enhanced deduction, equipment contributed must have been constructed or assembled by the taxpayer and be donated no later than three years after completion. This provision expires with respect to donations made after December 31, 2007. The Administration proposes to permanently extend this deduction, effective for distributions made in taxable years beginning after December 31, 2007.

Permanently increase limits on contributions of property interests made for conservation purposes.—In general, a deduction is permitted for charitable contributions, subject to certain limitations that depend on the type of taxpayer, the property contributed, and the donee organization. Exceptions to these general rules are provided for certain types of contributions, including qualified conservation contributions. The special rules for qualified conservation contributions were enhanced under the Pension Reform Act of 2006, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2005 and before January 1, 2008. These special rules: (1) increased the cap on deductions for qualified conservation contributions from 30 percent to 50 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions, (2) increased the cap on deductions for qualified conservation contributions applicable to qualified ranchers and farmers to 100 percent of the excess of the donor's contribution base over the amount of all other allowable charitable contributions in the case of individuals and to 100 percent of the excess of taxable income over the amount of all other allowable charitable contributions in the case of corporations, and (3) increased the number of years qualified conservation contributions in excess of the 50- and 100-percent caps may be carried forward from five to 15 years. The Administration proposes to permanently extend these special rules, applicable for qualified conservation contributions made in taxable years beginning after December 31, 2007.

Extend permanently basis adjustment to stock of S corporations contributing appreciated property.—Each shareholder of an S corporation must take into account his or her pro rata share of a charitable contribution by the S corporation in determining his or her income tax liability. For donations of property, this generally is the pro rata share of the property's fair market value. Under prior law, the shareholder's basis in the stock of the company was reduced by the amount of the charitable contribution that flowed through to the shareholder. Under the Pension Protection Act of 2006, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2005 and before January 1, 2008, shareholders are allowed to adjust their basis in the stock of the company by their pro rata share of the adjusted basis of the contributed property instead of by their pro rata share of the market value of the contributed property. The Administration proposes to permanently extend this provision, effective for charitable contributions made by an S corporation in taxable years beginning after December 31, 2007.

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 that 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, 2007.

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 permanently 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 (deductible above-the-line). Unreimbrsed 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. This additional deduction is effective for expenses incurred in table years beginning after December 31, 2001 and before January 1, 2008. The Administration proposes to extend permanently the above-the-line deduction to apply to qualified out-of-pocket expenditures incurred in taxable years beginning after December 31, 2007.

Allow the saver's credit for contributions to qualified tuition programs (section 529 of the Internal Revenue Code).—Under current law, taxpayers age 18 or older who are not dependents or full-time students may receive a nonrefundable credit (the saver's credit) on up to $2,000 of their compensation contributed to employer-sponsored qualified retirement plans and IRAs. The credit ranges between 10 and 50 percent of the amount contributed, depending on the taxpayer's filing status and AGI (adjusted for inflation). In determining the credit, qualified contributions are reduced by distributions from qualified plans and IRAs during the current tax year, the two preceding tax years, and the following year, up to the due date of the return, including extensions.

Under current law, taxpayers may contribute to a section 529 qualified tuition program (QTP) to save for higher education expenses of a designated beneficiary. Contributions to a QTP are not deductible from income for Federal tax purposes, but earnings on contributions accumulate tax-free. Taxpayers may exclude from gross income amounts distributed from a QTP and used for qualified higher education expenses, provided the distribution is not used for the same educational expenses for which another tax benefit is claimed. Nonqualified distributions are subject to an additional tax.

The Administration proposes to allow the saver's credit for qualified contributions to QTPs controlled by the taxpayer. AGI would be modified to include the excludable portion of the taxpayer's Social Security benefits in determining the applicable rate for the saver's credit. The credit would apply to an annual aggregate contribution of up to $2,000 (or earnings includible in gross income, if less) to the taxpayer's elective deferral plans, IRAs, and QTPs. For an individual who is married filing a joint return, the earnings limitation would be binding only if the combined includible compensation of the spouses was less than $4,000. Qualified contributions would be reduced by distributions from elective deferral plans, IRAs, and QTPs during the current tax year, the two preceding tax years, and the following tax year up to the due date of the return, including extensions. The credit would be effective for years beginning after December 31, 2007.

Protect the Environment

Extend permanently expensing of brownfields remediation costs.—Taxpayers may elect, with respect to expenditures paid or incurred before January 1, 2008, 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, 2007, and facilitating its use by businesses to undertake projects that may be uncertain in overall duration.

Eliminate the volume cap for private activity bonds for water infrastructure.—Bonds are classified as private activity bonds if they meet a private business use test and a private payments test. Private activity bonds may be issued on a tax-exempt basis only if they meet specified requirements, including targeting requirements that limit such bond financing to specifically defined facilities and programs. For example, qualified private activity bonds can be used to finance facilities for the furnishing of water and for sewer facilities. Qualified private activity bonds are subject to the same general rules applicable to governmental bonds. Most qualified private activity bonds are also subject to a number of additional rules and limitations, in particular an annual State volume cap limitation.

The Administration proposes to remove from the annual State volume cap limitation qualified private activity bonds issued to finance water and sewage facilities. Municipalities that use these bonds for wastewater and drinking water systems must implement (if they have not already) full-cost pricing for services, to help their systems become self-financing like the electric and gas utilities and minimize the need for future Federal financing. The volume cap would be removed for obligations issued after December 31, 2007.

Restructure Assistance to New York City for Continued Recovery from the Attacks of September 11th

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. The Administration also proposes to terminate the additional first-year depreciation deduction for certain real property, which was provided to eligible property within the New York Liberty Zone under the 2002 economic stimulus act.

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 the tax code.

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 AGI 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, 2007.

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 simplification of the filing status and residency requirements would be effective for taxable years beginning after December 31, 2007. Effective January 1, 2008, the proposal would also improve the administration of the EITC with respect to eligibility requirements for undocumented workers.

Reduce computational complexity of refundable child tax credit.—Taxpayers with earned income in excess of $11,750 may qualify for a refundable (or "additional") child tax credit even if they do not have any income tax liability. Over 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, 2007.

IMPROVE TAX COMPLIANCE

The Federal tax system is based on voluntary compliance with the tax laws. Under this system, taxpayers report and pay their taxes voluntarily with minimal interaction with the IRS. While the vast majority of American taxpayers pay their taxes timely and accurately, there remains in aggregate a difference between what taxpayers should pay and what they actually pay on a timely basis. In 2001, the overall compliance rate was 86 percent, after including late payments and recoveries from IRS enforcement activities. While this rate of compliance is high, a large amount of the tax that should be paid is not, resulting in the so-called "tax gap".[1]

In September 2006, the Treasury Department released a comprehensive strategy to improve tax compliance.[2] The strategy builds upon the demonstrated experience and current efforts of the Treasury Department and IRS to improve compliance.

Four key principles guided development of the strategy:

- Unintentional taxpayer errors and intentional taxpayer evasion should both be addressed.
- Sources of non-compliance should be targeted with specificity.
- Enforcement activities should be combined with a commitment to taxpayer service.
- Tax policy and compliance proposals should be sensitive to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden.

[1] See Chapter 13, Stewardship, in the *Analytical Perspectives* volume.

[2] Comprehensive Strategy for Reducing the Tax Gap, U.S. Treasury Department, September 26, 2006.

These principles point to the need for a comprehensive, integrated, multi-year strategy to improve tax compliance. Components of this strategy must include: (1) legislative proposals to reduce opportunities for evasion; (2) a multi-year commitment to compliance research; (3) continued improvements in information technology; (4) improvements in IRS compliance activities; (5) enhancements of taxpayer service; (6) simplification of the tax law; and (7) coordination between the government and its partners and stakeholders.

The IRS has taken a number of steps to improve compliance. To enhance the IRS' efforts, the Administration's Budget includes a number of legislative proposals intended to improve tax compliance with minimum taxpayer burden. The Administration proposes to expand information reporting, improve compliance by businesses, strengthen tax administration, and expand penalties.

Expand information reporting.—Compliance with the tax laws is highest when payments are subject to information reporting to the IRS. Specific information reporting proposals would: (1) require information reporting on payments to corporations; (2) require basis reporting on security sales; (3) expand broker information reporting; (4) require information reporting on merchant payment card reimbursements; (5) require a certified tax identification number (TIN) from non-employee service providers; (6) require increased information reporting for certain government payments for property and services; and (7) increase information return penalties.

Improve compliance by businesses.—Improving compliance by businesses of all sizes is important. Specific proposals to improve compliance by businesses would: (1) require electronic filing by certain large businesses; (2) implement standards clarifying when employee leasing companies can be held liable for their clients' Federal employment taxes; and (3) amend collection due process procedures applicable to employment tax liabilities.

Strengthen tax administration.—The IRS has taken a number of steps under existing law to improve compliance. These efforts would be enhanced by specific tax administration proposals that would: (1) expand IRS access to information in the National Directory of New Hires database; (2) permit the IRS to disclose to prison officials return information about tax violations; and (3) make repeated failure to file a tax return a felony.

Expand penalties.—Penalties play an important role in discouraging intentional non-compliance. Specific proposals to expand penalties would: (1) expand preparer penalties; (2) impose a penalty on failure to comply with electronic filing requirements; and (3) create an erroneous refund claim penalty.

IMPROVE TAX ADMINISTRATION AND OTHER MISCELLANEOUS PROPOSALS

Implement IRS administrative reforms.—The Administration has four proposals relating to administrative reforms. The first proposal 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 proposal allows the IRS to terminate installment agreements when taxpayers fail to make timely tax deposits and file tax returns on current liabilities. The third proposal 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. The fourth proposal modifies the way that Financial Management Services (FMS) recovers its transaction fees for processing IRS levies by permitting FMS to add the fee to the liability being recovered thereby shifting the cost of collection to the delinquent taxpayer. The offset amount would be included as part of the 15-percent limit on continuous levies against income.

Extend IRS authority to fund undercover operations.—The IRS is permitted to fund certain necessary and reasonable expenses of undercover operations, placing it on equal footing with other Federal law enforcement agencies. 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, 2007, through December 31, 2010.

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, 2007.

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.

Repeal telephone tax on local telephone service.—Under prior law, a three-percent Federal excise tax was imposed on amounts paid for local telephone service, toll telephone service (essentially long distance telephone service), and teletypewriter exchange service. In accordance with multiple court decisions that concluded that the tax did not apply to long distance services sold at flat per-minute rates for interstate, intrastate, and international calls, the IRS is no longer collecting tax on telephone service other than local-only telephone service. The Administration proposes to repeal the tax on local telephone service effective for amounts paid pursuant to bills first rendered more than 90 days after enactment of legislation repealing the tax.

Modify financing of the Airport and Airway trust fund.—The Administration supports a reauthorization proposal that would make the Federal Aviation Administration's (FAA's) financing system more cost-based. The FAA's current excise tax system, largely based on taxes on the price of airline tickets, does not have a direct relationship between the taxes paid by users and the air traffic control services provided by the FAA. Under the reauthorization proposal, FAA would collect user fees from commercial aviation operators for air traffic control services starting in 2009. For non-commercial users, FAA would continue to recover its costs for air traffic control services via a fuel tax. Both commercial and non-commercial users would continue to pay fuel taxes to support FAA's Airport Improvement Program.

Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund.—The President's National Parks Centennial Challenge encourages the public to increase donations to national parks by proposing to match contributions for signature projects and programs on a dollar-for-dollar basis up to $100 million a year for ten years. As part of a broader initiative to prepare for the National Park Service Centennial in 2016, this Challenge continues the National Park Service's legacy of leveraging philanthropic investment for the benefit of our national parks.

Transition from the non-foreign cost-of-living adjustment (COLA) to locality pay for employees in non-foreign areas.—Federal employees working outside the continental United States in Alaska, Hawaii or the US territories presently receive a COLA, which is an untaxed annual pay adjustment that is not creditable for retirement. By transitioning to locality pay, Federal employees in the non-foreign areas will contribute a larger percentage of their pay into the Federal retirement fund as locality pay is retirement-creditable. The proposal would establish a yearly reduction in the COLA, offset by a yearly increase in applicable locality pay, with the intent of eliminating the COLA over seven years.

IMPROVE 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 improve the administration of the UI program, such as speeding reemployment of UI beneficiaries. 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 Federal unemployment tax on employers is scheduled to drop from 0.8 percent to 0.6 percent with respect to wages paid after December 31, 2007. The 0.8 percent rate is proposed to be extended for five years, through December 31, 2012.

MODIFY ENERGY PROVISIONS

Repeal reduced recovery period for natural gas distribution lines.—The Energy Policy Act of 2005 reduced the recovery period for new natural gas distribution lines that are placed in service before January 1, 2011 from 20 years to 15 years. The Administration proposes to repeal this provision for natural gas distribution lines placed in service after December 31, 2007.

Modify 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. Under the Energy Policy Act of 2005, 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, could be amortized over two years. The Tax Increase Prevention and Reconciliation Act of 2006 increased the amortization period to five years for G&G costs paid or incurred by certain major integrated oil companies after May 17, 2006. This five-year amortization rule applies only to integrated oil companies that have an average daily worldwide production of crude oil of at least 500,000 barrels for the taxable year, have gross receipts in excess of $1 billion in the last taxable year ending during calendar year 2005, and either are a crude oil refiner or have an ownership interest in a crude oil refiner of 15 percent or more. The Administration proposes to increase the amortization period to five years for all companies, effective for amounts paid or incurred in taxable years beginning after December 31, 2007.

PROMOTE TRADE

Implement free trade agreements.—Free trade agreement negotiations with Panama were completed, with the expectation that implementation could begin as early as FY 2008. The FTA signed with Peru and the recently completed agreement with Colombia could also begin implementation in FY 2008. Free trade agreements are expected to be completed with Korea, Malaysia, and the United Arab Emirates (UAE), with implementation to begin in FY 2009. 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.

Establish Reconstruction Opportunity Zones (ROZs) in Pakistan and Afghanistan.—In March 2006, the President announced his intention to establish ROZs in Afghanistan and the border regions of Pakistan. ROZs are a critical part of the Administration's broader counterterrorism strategy in these areas, designed to connect isolated regions to the global economy and create vital employment opportunities in territories prone to extremism. The creation of ROZs will encourage investment and economic development in these areas by granting duty-free entry to the United States for certain goods produced in designated territories. By stimulating economic activity in remote and underdeveloped regions, ROZs can also serve as a powerful catalyst for peace, prosperity, stability, growth and good governance. In early 2007, the Administration will work closely with Congress and private sector stakeholders to implement this important initiative.

EXTEND EXPIRING PROVISIONS

Extend AMT relief for individuals.—A temporary provision of current law increased the AMT exemption amounts to $42,500 for single taxpayers, $62,550 for married taxpayers filing a joint return and surviving spouses, and $31,275 for married taxpayers filing a separate return and estates and trusts. Effective for taxable years beginning after December 31, 2006, 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. A temporary provision of current law permits nonrefundable personal tax credits to offset both the regular tax and the AMT for taxable years beginning before January 1, 2007.

The Administration proposes to increase the AMT exemption amounts to $43,900 for single taxpayers, $65,350 for married taxpayers filing a joint return, and $32,675 for married taxpayers filing a separate return and estates and trusts through taxable year 2007 to prevent the number of AMT taxpayers from increasing. Non-refundable personal tax credits also would be allowed to offset both the regular tax and the AMT through taxable year 2007.

Extend permanently the research and experimentation (R&E) tax credit.—The Administration proposes to extend permanently the tax credits for research and experimentation expenditures, which are scheduled to expire with respect to expenditures incurred after December 31, 2007.

Extend the work opportunity tax credit.—The work opportunity tax credit provides incentives for hiring individuals from certain targeted groups. The credit applies to wages paid to qualified individuals who begin work for the employer before January 1, 2008. The Administration proposes to extend the credit for one year, making it applicable to wages paid to qualified individuals who begin work after December 31, 2007 and before January 1, 2009.

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, 2007. The Administration proposes to extend the credit for one year, making the credit available with respect to purchases after December 31, 2007 and before January 1, 2009.

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 2007. 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 2007 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 2008; unused authority could be carried forward for up to two years. Reporting of issuance would be required.

Extend deferral of gains from sales of electric transmission property.—Generally, the gain on the sale of business assets is subject to current income tax unless a special rule provides for nonrecognition or deferral of the gain. One such special rule applies to qualifying electric transmission transactions. Under this rule, a taxpayer may elect to recognize the gain from a qualifying electric transmission transaction ratably over the eight-year period beginning with the year of the transaction. Deferral is allowed only with respect to proceeds that are used to purchase other gas or electric utility property during the four-year period beginning on the date of the transaction (the reinvestment period). A sale or other disposition of property is a qualifying electric transmission transaction if: (1) the property is used in the trade or business of providing electric transmission services or is an ownership interest in a entity whose principal trade or business is providing electric transmission services, and (2) the sale or other disposition is to an independent transmission company and occurs before January 1, 2008. In general, whether the purchaser qualifies as an independent transmission company depends on determinations by the Federal Energy Regulatory Commission (FERC) or, in the case of facilities subject to the jurisdiction of the Public Utility Commission of Texas, by that Commission. The special rule allowing the deferral of tax on the gain from the sale or disposition of electric transmission property would be extended for one year, allowing taxpayers to elect deferral with respect to sales or dispositions that occur before January 1, 2009.

Extend provisions permitting disclosure of tax return information relating to terrorist activity.—The disclosure of tax return information relating to terrorism is permitted 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, 2007, through December 31, 2008.

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.

Extend the exception for retirement plan distributions provided individuals called to active duty for at least 179 days.—Under current law, a taxpayer who receives a distribution from a qualified retirement plan prior to age 59½, death or disability is subject to a 10-percent early withdrawal tax unless a specific exception to the tax applies. One of the exceptions to the tax applies to qualified reservist distributions. An individual who receives a qualified reservist distribution may, at any time during a two-year period beginning on the day after the end of the active duty period, make contributions to an IRA in an amount not exceeding the amount of the qualified reservist distribution. Such contributions are not subject to the dollar limitations otherwise applicable to contributions to IRAs. The exception to the tax for qualified reservist distributions applies to individuals ordered or called to active duty after September 11, 2001 and before December 31, 2007. The Administration proposes to extend the exception to individuals ordered or called to active duty before December 31, 2008.

Table 17–3. EFFECT OF PROPOSALS ON RECEIPTS

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Make Permanent Certain Tax Relief Enacted in 2001 and 2003 (assumed in the baseline):								
Dividends tax rate structure	344	683	695	–3,595	–13,789	1,491	–14,515	–89,973
Capital gains tax rate structure	....	....	....	–3,405	–17,477	–7,269	–28,151	–79,059
Expensing for small business	....	....	....	–3,728	–4,947	–3,376	–12,051	–20,158
Marginal individual income tax rate reductions	....	....	....	....	–71,892	–113,251	–185,143	–793,780
Child tax credit [1]	....	....	....	....	–5,265	–21,128	–26,393	–135,380
Marriage penalty relief [1]	....	....	....	....	–5,380	–7,971	–13,351	–41,317
Education incentives	....	....	....	....	–739	–1,336	–2,075	–9,673
Repeal of estate and generation-skipping transfer taxes, and modification of gift taxes	–156	–1,373	–2,290	–3,067	–26,845	–57,652	–91,227	–442,490
Other incentives for families and children	....	....	....	6	–179	–866	–1,039	–5,341
Total, make permanent certain tax relief enacted in 2001 and 2003	188	–690	–1,595	–13,789	–146,513	–211,358	–373,945	–1,617,171
Tax Incentives:								
Simplify and encourage saving:								
Expand tax-free savings opportunities	....	1,527	3,545	3,023	1,075	–1,314	7,856	–592
Consolidate employer-based savings accounts	....	–80	–120	–132	–141	–150	–623	–1,484
Total, simplify and encourage saving	....	1,447	3,425	2,891	934	–1,464	7,233	–2,076
Encourage entrepreneurship and investment:								
Increase expensing for small business	....	–1,597	–2,180	–1,541	–1,135	–847	–7,300	–10,095
Invest in health care:								
Provide a flat $15,000 deduction for family coverage ($7,500 for individual coverage) for those with and who purchase health insurance [1]	....	....	–31,433	–38,892	–30,843	–20,033	–121,201	5,150
Expand and make health savings accounts (HSAs) more flexible	....	–318	–593	–784	–937	–1,037	–3,669	–10,366
Improve the Health Coverage Tax Credit [1]	....	–1	–3	–4	–5	–5	–18	–51
Allow the orphan drug tax credit for certain pre-designation expenses	....	....	....	....	....	....	....	–1
Total, invest in health care	....	–319	–32,029	–39,680	–31,785	–21,075	–124,888	–5,268
Provide incentives for charitable giving:								
Extend permanently tax-free withdrawals from IRAs for charitable contributions	....	–120	–255	–235	–171	–147	–928	–1,867
Extend permanently the enhanced charitable deduction for contributions of food inventory	....	–44	–96	–106	–116	–127	–489	–1,345
Extend permanently the deduction for corporate donations of computer technology	....	–50	–118	–147	–154	–162	–631	–1,570
Permanently increase limits on contributions of property interests made for conservation purposes	....	–48	–35	–22	–18	–21	–144	–265
Extend permanently basis adjustment to stock of S corporations contributing appreciated property	....	–3	–15	–21	–25	–28	–92	–301
Reform excise tax based on investment income of private foundations	....	–61	–91	–97	–103	–110	–462	–1,163
Repeal the $150 million limitation on qualified 501(c)(3) bonds	....	–2	–3	–9	–13	–14	–41	–104
Repeal certain restrictions on the use of qualified 501(c)(3) bonds for residential rental property	....	–2	–5	–10	–17	–24	–58	–286
Total, provide incentives for charitable giving	....	–330	–618	–647	–617	–633	–2,845	–6,901
Strengthen education:								
Extend permanently the above-the-line deduction for qualified out-of-pocket classroom expenses	....	–18	–180	–183	–185	–188	–754	–1,739

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

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Allow the saver's credit for contributions to qualified tuition programs	....	–63	–163	–176	–189	–200	–791	–1,966
Total, strengthen education	....	–81	–343	–359	–374	–388	–1,545	–3,705
Protect the environment:								
Extend permanently expensing of brownfields remediation costs	61	–244	–400	–352	–342	–331	–1,669	–2,851
Eliminate the volume cap for private activity bonds for water infrastructure	....	–1	–3	–5	–9	–13	–31	–184
Total, protect the environment	61	–245	–403	–357	–351	–344	–1,700	–3,035
Restructure assistance to New York City for continued recovery from the attacks of September 11th:								
Provide tax incentives for transportation infrastructure	....	–200	–200	–200	–200	–200	–1,000	–2,000
Total, tax incentives	61	–1,325	–32,348	–39,893	–33,528	–24,951	–132,045	–33,080
Simplify the Tax Laws for Families:								
Clarify uniform definition of a child [1]	17	64	48	31	40	15	198	350
Simplify EITC eligibility requirement regarding filing status, presence of children, and work and immigration status [1]	....	31	–25	–22	–22	–21	–59	–164
Reduce computational complexity of refundable child tax credit [1]	....	....	....	....	....	....	....	....
Total, simplify the tax laws for families	17	95	23	9	18	–6	139	186
Improve Tax Compliance: [5]								
Expand information reporting	....	232	1,075	1,848	2,488	2,903	8,546	28,849
Improve compliance by businesses	....	143	91	38	21	20	313	421
Strengthen tax administration	....	....	....	1	1	1	3	17
Expand penalties	....	3	5	11	18	20	57	178
Total, improve tax compliance	....	378	1,171	1,898	2,528	2,944	8,919	29,465
Improve Tax Administration and Other Miscellaneous Proposals:								
Implement IRS administrative reforms and extend IRS authority to fund undercover operations [4]	....	....	....	....	....	....	....	....
Eliminate the special exclusion from unrelated business taxable income for gain or loss on the sale or exchange of certain brownfields	....	2	14	28	28	23	95	126
Limit related party interest deductions	86	148	155	163	171	180	817	1,859
Repeal excise tax on local telephone service [2]	–552	–463	–148	–74	–74	–74	–833	–1,211
Modify financing of the Airport and Airway trust fund [2]	....	....	–6,407	–6,705	–7,005	–7,326	–27,443	–69,732
Anticipated receipt of donations to the National Park Service through the National Park Centennial Challenge Fund	....	100	100	100	100	100	500	1,000
Transition from the non-foreign COLA to locality pay for employees in non-foreign areas	....	1	2	3	4	5	15	50
Total, improve tax administration and other miscellaneous proposals [2]	–466	–212	–6,284	–6,485	–6,776	–7,092	–26,849	–67,908
Improve Unemployment Insurance:								
Strengthen the financial integrity of the unemployment insurance system by reducing improper benefit payments and tax avoidance [2]	....	....	29	29	–16	–64	–22	–1,469
Extend unemployment insurance surtax [2]	....	1,073	1,542	1,580	1,617	1,633	7,445	1,526
Total, improve unemployment insurance [2]	....	1,073	1,571	1,609	1,601	1,569	7,423	57
Modify Energy Provisions:								
Repeal reduced recovery period for natural gas distribution lines	....	52	88	107	119	106	472	906
Modify amortization for certain geological and geophysical expenditures	....	15	55	81	67	56	274	582
Indirect effect of energy proposals [3]	....	–45	–93	–163	–92	–98	–491	–1,019
Total, modify energy provisions	....	22	50	25	94	64	255	469
Promote Trade:								
Implement free trade agreements and modify other trade-related provisions [2]	....	–241	–502	–760	–994	–1,240	–3,737	–13,072
Extend Expiring Provisions:								
AMT relief for individuals	–9,123	–47,922	11,431	....	....	....	–36,491	–36,491
Research & Experimentation (R&E) tax credit	....	–3,221	–7,071	–9,145	–10,601	–11,799	–41,837	–117,309
Work opportunity tax credit	....	–71	–192	–162	–80	–51	–556	–582
First-time homebuyer credit for DC	....	–1	–19	....	....	....	–20	–20
Authority to issue Qualified Zone Academy Bonds	....	–3	–8	–13	–18	–20	–62	–162
Deferral of gains from sales of electric transmission property	–63	–48	–52	–65	–39	5	–199	41
Disclosure of tax return information related to terrorist activity [4]	....	....	....	....	....	....	....	....
Excise tax on coal [2]	....	....	....	....	....	....	....	1,081

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

(In millions of dollars)

	2007	2008	2009	2010	2011	2012	2008–12	2008–17
Exception for retirement plan distributions provided individuals called to active duty for at least 179 days	–*	–*	–*	–*	–*	–*	–*	–*
Total, extend expiring provisions [2]	–9,186	–51,266	4,089	–9,385	–10,738	–11,865	–79,165	–153,442
Total budget proposals, including proposals assumed in the baseline [2]	–9,386	–52,166	–33,825	–66,771	–194,308	–251,935	–599,005	–1,854,496
Total budget proposals, excluding proposals assumed in the baseline [2]	–9,574	–51,476	–32,230	–52,982	–47,795	–40,577	–225,060	–237,325

* $500,000 or less.
[1] Affects both receipts and outlays. Only the receipt effect is shown here. For the outlay effect, see summary Table S–5 of the *Budget* volume.
[2] Net of income offsets.
[3] Indirect effect on receipts of proposed alternative fuels and fuel efficiency standards. These proposals are discussed in the Energy chapter of the *Budget* volume.
[4] No net budgetary impact.
[5] "Tax gap"-related proposals.

Table 17–4. RECEIPTS BY SOURCE

(In millions of dollars)

Source	2006 Actual	Estimate 2007	2008	2009	2010	2011	2012
Individual income taxes (federal funds):							
Existing law	1,043,908	1,177,703	1,294,636	1,349,248	1,476,448	1,673,666	1,819,724
Proposed legislation	....	–8,857	–48,022	–18,111	–48,131	–156,377	–183,157
Total individual income taxes	**1,043,908**	**1,168,846**	**1,246,614**	**1,331,137**	**1,428,317**	**1,517,289**	**1,636,567**
Corporation income taxes:							
Federal funds:							
Existing law	353,914	341,867	318,385	326,647	334,665	350,891	377,546
Proposed legislation	....	190	–3,444	–6,837	–9,206	–10,314	–10,910
Total Federal funds corporation income taxes	353,914	342,057	314,941	319,810	325,459	340,577	366,636
Trust funds:							
Hazardous substance superfund	1	....	....	....	....	....	....
Total corporation income taxes	**353,915**	**342,057**	**314,941**	**319,810**	**325,459**	**340,577**	**366,636**
Social insurance and retirement receipts (trust funds):							
Employment and general retirement:							
Old-age and survivors insurance (Off-budget)	520,069	542,098	576,237	608,106	643,935	680,272	714,061
Disability insurance (Off-budget)	88,313	92,032	97,848	103,264	109,347	115,518	121,256
Hospital insurance	177,429	185,163	198,726	208,700	221,160	233,811	245,766
Railroad retirement:							
Social Security equivalent account	1,894	1,993	2,073	2,137	2,203	2,258	2,319
Rail pension and supplemental annuity	2,338	2,364	2,441	2,529	2,473	2,507	2,712
Total employment and general retirement	790,043	823,650	877,325	924,736	979,118	1,034,366	1,086,114
On-budget	181,661	189,520	203,240	213,366	225,836	238,576	250,797
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
Unemployment insurance:							
Deposits by States [1]	35,938	37,574	37,584	36,792	37,203	38,150	39,352
Proposed legislation	....	....	....	36	36	–20	–108
Federal unemployment receipts [1]	7,394	7,323	6,183	5,785	5,925	6,065	6,207
Proposed legislation	....	....	1,341	1,928	1,975	2,022	2,069
Railroad unemployment receipts [1]	88	88	95	106	112	114	122
Total unemployment insurance	43,420	44,985	45,203	44,647	45,251	46,331	47,642
Other retirement:							
Federal employees' retirement—employee share	4,308	4,704	4,633	4,798	4,909	4,964	4,972
Proposed legislation	....	....	1	2	3	4	5
Non-Federal employees retirement [2]	50	38	33	31	28	26	23
Total other retirement	4,358	4,742	4,667	4,831	4,940	4,994	5,000
Total social insurance and retirement receipts	**837,821**	**873,377**	**927,195**	**974,214**	**1,029,309**	**1,085,691**	**1,138,756**
On-budget	229,439	239,247	253,110	262,844	276,027	289,901	303,439
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
Excise taxes:							
Federal funds:							
Alcohol taxes	8,484	8,614	8,798	8,953	9,109	9,318	9,524
Proposed legislation	....	....	–76	–26	....	....	....
Tobacco taxes	7,710	7,605	7,496	7,393	7,298	7,208	7,123
Transportation fuels tax	–2,386	–2,960	–3,459	–4,101	–4,798	–1,227	234
Proposed legislation	....	....	–74	–139	–190	–57	....
Telephone and teletype services	4,897	–10,892	–1,712	197	100	100	100
Proposed legislation	....	–736	–616	–197	–100	–100	–100
Other Federal fund excise taxes	3,755	1,493	1,932	1,987	2,057	2,128	2,208
Proposed legislation	....	....	15	–121	–155	–163	–172
Total Federal fund excise taxes	22,460	3,124	12,304	13,946	13,321	17,207	18,917

Table 17–4. RECEIPTS BY SOURCE—Continued

(In millions of dollars)

Source	2006 Actual	Estimate					
		2007	2008	2009	2010	2011	2012
Trust funds:							
Highway	38,378	39,707	40,858	41,911	42,696	43,402	44,045
Proposed legislation	....	....	12	14	–27	–65	–131
Airport and airway	10,590	11,426	12,094	12,808	13,556	14,341	15,162
Proposed legislation	....	....	....	–8,485	–8,882	–9,279	–9,706
Sport fish restoration and boating safety	519	547	564	581	600	619	638
Tobacco assessments	891	960	960	960	960	960	960
Black lung disability insurance	607	624	629	640	659	679	692
Inland waterway	81	84	85	86	87	88	89
Oil spill liability	54	199	205	214	225	233	244
Vaccine injury compensation	184	195	196	198	199	202	203
Leaking underground storage tank	197	196	199	204	206	210	212
Total trust funds excise taxes	51,501	53,938	55,802	49,131	50,279	51,390	52,408
Total excise taxes	**73,961**	**57,062**	**68,106**	**63,077**	**63,600**	**68,597**	**71,325**
Estate and gift taxes:							
Federal funds	27,877	25,260	26,786	28,757	22,920	20,407	48,691
Proposed legislation	....	17	–1,081	–1,318	–1,179	–18,733	–48,170
Total estate and gift taxes	**27,877**	**25,277**	**25,705**	**27,439**	**21,741**	**1,674**	**521**
Customs duties:							
Federal funds	23,533	25,430	28,105	29,786	32,066	33,837	35,501
Proposed legislation	....	....	–322	–671	–1,015	–1,326	–1,655
Trust funds	1,277	1,336	1,440	1,536	1,637	1,740	1,849
Total customs duties	**24,810**	**26,766**	**29,223**	**30,651**	**32,688**	**34,251**	**35,695**
MISCELLANEOUS RECEIPTS: [3]							
Miscellaneous taxes	423	534	542	549	558	567	577
Exercise of warrants	118	....	....	....	....	....	....
United Mine Workers of America combined benefit fund	119	72	65	44	24	5	3
Deposit of earnings, Federal Reserve System	29,945	32,638	36,115	37,625	39,040	40,680	42,804
Defense cooperation	12	8	8	8	8	8	8
Fees for permits and regulatory and judicial services	10,226	10,083	10,468	10,600	10,806	11,020	11,213
Fines, penalties, and forfeitures	3,796	3,243	3,254	2,910	2,929	2,948	2,969
Gifts and contributions	378	189	194	199	201	203	206
Proposed legislation	....	....	100	100	100	100	100
Refunds and recoveries	–55	–56	–56	–56	–56	–56	–56
Total miscellaneous receipts	**44,962**	**46,711**	**50,690**	**51,979**	**53,610**	**55,475**	**57,824**
Total budget receipts	**2,407,254**	**2,540,096**	**2,662,474**	**2,798,307**	**2,954,724**	**3,103,554**	**3,307,324**
On-budget	1,798,872	1,905,966	1,988,389	2,086,937	2,201,442	2,307,764	2,472,007
Off-budget	608,382	634,130	674,085	711,370	753,282	795,790	835,317
MEMORANDUM							
Federal funds	1,517,453	1,635,493	1,681,337	1,774,042	1,874,190	1,965,503	2,115,280
Trust funds	616,863	653,127	692,062	709,365	747,034	789,414	827,684
Interfund transactions	–335,444	–382,654	–385,010	–396,470	–419,782	–447,153	–470,957
Total on-budget	**1,798,872**	**1,905,966**	**1,988,389**	**2,086,937**	**2,201,442**	**2,307,764**	**2,472,007**
Off-budget (trust funds)	**608,382**	**634,130**	**674,085**	**711,370**	**753,282**	**795,790**	**835,317**
Total	**2,407,254**	**2,540,096**	**2,662,474**	**2,798,307**	**2,954,724**	**3,103,554**	**3,307,324**

[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.