

**[JOINT COMMITTEE PRINT]**

**DESCRIPTION OF CERTAIN REVENUE PROVISIONS  
CONTAINED IN THE PRESIDENT'S  
FISCAL YEAR 2020 BUDGET PROPOSAL**

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



July 2019

U.S. Government Publishing Office  
Washington: 2019

JCS-1-19

**[JOINT COMMITTEE PRINT]**

**DESCRIPTION OF CERTAIN REVENUE PROVISIONS  
CONTAINED IN THE PRESIDENT'S  
FISCAL YEAR 2020 BUDGET PROPOSAL**

Prepared by the Staff  
of the  
JOINT COMMITTEE ON TAXATION



July 2019

U.S. Government Publishing Office  
Washington: 2019

JCS-1-19

**JOINT COMMITTEE ON TAXATION**

**116TH CONGRESS, 1<sup>ST</sup> SESSION**

---

HOUSE

Richard Neal, *Massachusetts*  
*Chairman*

John Lewis, *Georgia*

Lloyd Doggett, *Texas*

Kevin Brady, *Texas*

Devin Nunes, *California*

SENATE

Chuck Grassley, *Iowa*  
*Vice Chairman*

Mike Crapo, *Idaho*

Mike Enzi, *Wyoming*

Ron Wyden, *Oregon*

Debbie Stabenow, *Michigan*

Thomas A. Barthold, *Chief of Staff*

Robert P. Harvey, *Deputy Chief of Staff*

# CONTENTS

	<u>Page</u>
INTRODUCTION .....	1
PART I – MAKE PERMANENT INDIVIDUAL AND ESTATE TAX PROVISION IN THE 2017 TAX ACT .....	2
PART II – HEALTH .....	21
PART III – EDUCATION.....	40
A. Establish Education Freedom Scholarships.....	40
B. Provide Tax Exemption for Indian Health Service (IHS) Health Professions, NURSE Corps, and Native Hawaiian Scholarship and Loan Repayment Programs in Return for Obligatory Service Requirement.....	46
PART IV – TAX ADMINISTRATION.....	51
A. Provide Discretionary Funding for IRS Program Integrity Cap Adjustment .....	51
B. Increase Oversight of Paid Tax Return Preparers.....	53
C. Provide More Flexible Authority for the Internal Revenue Service to Address Correctable Errors.....	62
D. Expand Mandatory Electronic Filing of W-2s.....	69
E. Improve Clarity in Worker Classification Requirements and Information Reporting Requirements .....	73
F. Require a Social Security Number that is Valid for Work in Order to Claim Child Tax Credit, Earned Income Tax Credit, and/or Credit for Other Dependents .....	95
PART V – ENERGY .....	105
A. Repeal the Qualified Plug-In Electric Drive Motor Vehicle Credit .....	105
B. Repeal Exclusion of Utility Conservation Subsidies.....	107
C. Repeal Accelerated Depreciation for Renewable Energy Property.....	109
D. Repeal Energy Investment Credit .....	112
E. Repeal Credit for Residential Energy Efficient Property .....	116
PART VI – MISCELLANEOUS .....	118
A. Reinstate the Oil Spill Liability Trust Fund Excise Tax.....	118
B. Reform Inland Waterways Financing .....	120

APPENDIX – ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS  
CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2020 BUDGET PROPOSAL..... 123

## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation (“Joint Committee staff”), provides a description and analysis of certain revenue provisions modifying the Internal Revenue Code of 1986 (the “Code”) that are included in the President’s fiscal year 2020 budget proposal, “A Budget for a Better America,” as submitted to the Congress on March 11, 2019.<sup>2</sup> For each provision, there is a description of present law and the provision (including effective date), and an analysis of policy issues related to the provision. In addition, all provisions include a citation to *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, which is included as an appendix to this volume.

---

<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of Certain Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal* (JCS-1-19), July 2019.

<sup>2</sup> See Office of Management and Budget, *Budget of the U.S. Government Fiscal Year 2020: Analytical Perspectives* (H. Doc. 116-3, Vol. III), March 11, 2019, pp. 89-90, 142, 149-153.

## **PART I – MAKE PERMANENT INDIVIDUAL AND ESTATE TAX PROVISIONS IN THE 2017 TAX ACT**

### **Present Law**

An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (the “2017 Tax Act”) enacted a number of provisions that changed the income taxation of individuals, the income taxation of trusts and estates, and estate and gift taxation. A number of these changes expire for tax years beginning on or after January 1, 2026. These provisions are discussed below.

### **Income Taxation of Individuals**

#### Overview

##### In general

A United States citizen or resident alien generally is subject to the U.S. individual income tax on his or her worldwide taxable income.<sup>3</sup> Taxable income equals the individual taxpayer’s total gross income less certain exclusions, exemptions, and deductions. Graduated tax rates are then applied to a taxpayer’s taxable income to determine his or her individual income tax liability. An individual taxpayer may face additional liability if the alternative minimum tax applies. The taxpayer may reduce his or her income tax liability by any applicable tax credits.

##### Gross income and adjusted gross income

Under the Code, gross income means “income from whatever source derived” except for certain items specifically exempt or excluded by statute.<sup>4</sup> Sources of income<sup>5</sup> include compensation for services, interest, dividends, capital gains, rents, royalties, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income in respect of a decedent, and income from S corporations, partnerships,<sup>6</sup> estates, or trusts. Statutory exclusions from gross income include

---

<sup>3</sup> Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States. A U.S. citizen or resident who satisfies certain requirements for presence in a foreign country also is allowed a limited exclusion for foreign earned income and a limited exclusion of employer-provided housing costs. Sec. 911.

<sup>4</sup> Sec. 61. Unless otherwise indicated, all section citations are to the Internal Revenue Code of 1986, as amended.

<sup>5</sup> Generally, alimony and separate maintenance payments received are includable as income for divorce or separation instruments executed before January 1, 2019.

<sup>6</sup> In general, partnerships and S corporations are treated as pass-through entities for Federal income tax purposes. Thus, no Federal income tax is imposed at the entity level. Rather, income of such entities is passed through and taxed to the owners at the individual level. A business entity organized as a limited liability company (“LLC”) under applicable State law generally is treated as a partnership for Federal income tax purposes if it has two

death benefits payable under a life insurance contract, interest on certain State and local bonds, the receipt of property by gift or inheritance, as well as the value of employer-provided health insurance and certain other benefits. Contributions to qualified retirement plans, along with any attributable earnings, are generally included in gross income when distributed.

An individual taxpayer's adjusted gross income ("AGI") is determined by subtracting certain "above-the-line" deductions from gross income. These deductions include trade or business expenses, losses from the sale or exchange of property, contributions to a qualified retirement plan by a self-employed individual, contributions to certain individual retirement accounts, and certain education-related expenses.<sup>7</sup>

### Taxable income

To determine taxable income, an individual taxpayer reduces AGI by the applicable standard deduction or his or her itemized deductions.<sup>8</sup>

A taxpayer may reduce AGI by the amount of the applicable standard deduction to arrive at taxable income. The basic standard deduction varies depending on a taxpayer's filing status. An additional standard deduction is allowed with respect to any individual who is elderly (*i.e.*, above age 64) or blind. The amounts of the basic standard deduction and the additional standard deductions are indexed annually for inflation.

In lieu of taking the applicable standard deductions, a taxpayer may elect to itemize deductions. The deductions that may be itemized include State and local income taxes and property taxes, home mortgage interest (on mortgages up to certain specified dollar amounts), charitable contributions, certain investment interest, and medical expenses.

### Tax liability

#### In general

An individual taxpayer's net income tax liability is the greater of the taxpayer's (1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) tentative minimum tax reduced by credits allowed against the minimum tax. The amount of income subject to tax is determined differently under the regular tax and the alternative minimum tax, and separate rate schedules apply. Lower rates apply for long-term capital gains and certain dividends; those rates apply for both the regular tax and the alternative minimum tax.

---

or more members; a single-member LLC generally is disregarded as an entity separate from its owner for Federal income tax purposes.

<sup>7</sup> Sec. 62. Generally, alimony payments are deductible by the payor spouse for divorce and separation instruments executed before January 1, 2019.

<sup>8</sup> Sec. 63.

### Regular tax liability

To determine regular tax liability, an individual taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, with the marginal tax rate increasing as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status.

Effective marginal tax rates may be altered by the phasein and phaseout of certain exemptions or credits.<sup>9</sup>

### Special capital gains and dividends rates

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of a capital asset, any gain generally is included in income. Any net capital gain of an individual taxpayer is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the taxable year. Gain or loss is treated as long-term if the asset is held for more than one year. Qualified dividend income is generally taxed at the same rate as net capital gains.<sup>10</sup>

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

The maximum rate of tax on the adjusted net capital gain of an individual depends on the individual's taxable income and filing status. These maximum rates apply for purposes of both the regular tax and the alternative minimum tax.

### Net investment income

Individual taxpayers are also subject to an additional tax on net investment income.<sup>11</sup> The tax is 3.8 percent of the lesser of net investment income or the excess of modified AGI (as defined for purposes of the tax)<sup>12</sup> over the threshold amount. The threshold amount is \$250,000 in the case of a joint return or surviving spouse, \$125,000 in the case of a married individual

---

<sup>9</sup> The Code contains many provisions that may cause effective marginal tax rates to differ from statutory marginal rates. For a complete discussion of provisions that have an effect on effective marginal tax rates as applied to a prior iteration of the Code see Joint Committee on Taxation, *Present Law and Analysis Relating to Individual Effective Marginal Tax Rates* (JCS-3-98), February 3, 1998. This document can be found on the Joint Committee on Taxation website at <https://www.jct.gov/publications.html?func=startdown&id=2932>.

<sup>10</sup> Sec. 1(h).

<sup>11</sup> Sec. 1411.

<sup>12</sup> Modified adjusted gross income is adjusted gross income increased by the amount excluded from income as foreign earned income under section 911(a)(1) (net of the deductions and exclusions disallowed with respect to the foreign earned income).

filing a separate return, and \$200,000 in any other case.<sup>13</sup> Thus, for individual taxpayers with modified AGI in excess of those thresholds, the rate on certain capital gains and dividends is 23.8 percent while the maximum rate on other investment income, including interest, annuities, royalties, and rents, is 40.8 percent.

Net investment income is the excess of (1) the sum of (a) gross income from interest, dividends, annuities, royalties, and rents, other than such income which is derived in the ordinary course of a trade or business that is not a passive activity with respect to the taxpayer or a trade or business of trading in financial instruments or commodities, and (b) net gain (to the extent taken into account in computing taxable income) attributable to the disposition of property other than property held in the active conduct of a trade or business that is not in the trade or business of trading in financial instruments or commodities, over (2) deductions properly allocable to such gross income or net gain.

### Credits against tax

An individual taxpayer may reduce his or her income tax liability by available tax credits.<sup>14</sup> In some instances, a credit is wholly or partially “refundable.” That is, if the amount of these credits exceeds tax liability (net of other nonrefundable credits), such credits create an overpayment, which may generate a refund. Two major refundable credits are the child tax credit and the earned income tax credit.<sup>15</sup>

Tax credits are also allowed for certain business expenditures, certain foreign income taxes paid or accrued, certain energy conservation expenditures, certain education expenditures, certain child care expenditures, certain health care costs, and for certain elderly or disabled individuals. The personal credits allowed against the regular tax are generally allowed against the alternative minimum tax.

### Alternative minimum tax liability

An alternative minimum tax is imposed on an individual taxpayer in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year.<sup>16</sup> The tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed a

---

<sup>13</sup> These thresholds are not indexed for inflation.

<sup>14</sup> These personal credits include the child tax credit, earned income tax credit, child and dependent care credit, adoption credit, premium tax credit, health coverage tax credit, saver’s credit, foreign tax credit, lifetime learning credit, American opportunity tax credit, residential energy efficient property credit (for qualifying solar energy property), and credits for the elderly or disabled.

<sup>15</sup> Other refundable credits include the American opportunity tax credit, the premium tax credit, and the health coverage tax credit.

<sup>16</sup> Sec. 55.

specified breakpoint<sup>17</sup> and (2) 28 percent of the remaining taxable excess.<sup>18</sup> The taxable excess is so much of the alternative minimum taxable income (“AMTI”) as exceeds the exemption amount. AMTI is the taxpayer’s taxable income increased by certain tax preferences and adjusted by determining the tax treatment of certain items in a manner that negates the deferral or exclusion of income resulting from the regular tax treatment of those items.

Among the tax preferences and adjustments included in AMTI are accelerated depreciation on certain property used in a trade or business, circulation expenditures, research and experimental expenditures, certain expenses and allowances related to oil and gas, certain expenses and allowances related to mining exploration and development, certain tax-exempt interest income, and a portion of the gain excluded with respect to the sale or disposition of certain small business stock. The standard deduction, and certain itemized deductions, such as the deduction for State and local taxes paid or accrued, are not allowed to reduce AMTI.

The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual taxpayer’s AMTI exceeds an exemption amount phaseout threshold. The exemption amount and exemption amount phaseout threshold are indexed annually for inflation.

#### Changes made by the 2017 Tax Act

The 2017 Tax Act made the following changes to the income taxation of individuals, effective for taxable years beginning before January 1, 2026:

Modification of rates.—The 2017 Tax Act replaces the existing rate structure for individuals with a new rate structure that generally reduces tax rates.<sup>19</sup> The rate structure brackets are indexed for inflation. The rate structure for 2019 (including for trusts and estates) is reproduced immediately below.

---

<sup>17</sup> The breakpoint is indexed for inflation. For 2019, the breakpoint is \$194,800 (\$97,400 in the case of a married person filing a separate return).

<sup>18</sup> The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax.

<sup>19</sup> An Act to Provide for Reconciliation Pursuant to Titles II and V of the Concurrent Resolution on the Budget for Fiscal Year 2018 (the “2017 Tax Act”), Pub. L. No. 115-97, sec. 11001.

## Federal Individual Income Tax Rates for 2019

If taxable income is:	Then income tax equals:
<i>Single Individuals</i>	
Not over \$9,700	10% of the taxable income
Over \$9,700 but not over \$39,475	\$970 plus 12% of the excess over \$9,700
Over \$39,475 but not over \$84,200	\$4,543 plus 22% of the excess over \$39,475
Over \$84,200 but not over \$160,725	\$14,382.50 plus 24% of the excess over \$84,200
Over \$160,725 but not over \$204,100	\$32,748.50 plus 32% of the excess over \$160,725
Over \$204,100 but not over \$510,300	\$46,628.50 plus 35% of the excess over \$204,100
Over \$510,300	\$153,798.50 plus 37% of the excess over \$510,300
<i>Heads of Households</i>	
Not over \$13,850	10% of the taxable income
Over \$13,850 but not over \$52,850	\$1,385 plus 12% of the excess over \$13,850
Over \$52,850 but not over \$84,200	\$6,065 plus 22% of the excess over \$52,850
Over \$84,200 but not over \$160,700	\$12,962 plus 24% of the excess over \$84,200
Over \$160,700 but not over \$204,100	\$31,322 plus 32% of the excess over \$160,700
Over \$204,100 but not over \$510,300	\$45,210 plus 35% of the excess over \$204,100
Over \$510,300	\$152,380 plus 37% of the excess over \$510,300
<i>Married Individuals Filing Joint Returns and Surviving Spouses</i>	
Not over \$19,400	10% of the taxable income
Over \$19,400 but not over \$78,950	\$1,940 plus 12% of the excess over \$19,400
Over \$78,950 but not over \$168,400	\$9,086 plus 22% of the excess over \$78,950
Over \$168,400 but not over \$321,450	\$28,765 plus 24% of the excess over \$168,400
Over \$321,450 but not over \$408,200	\$65,497 plus 32% of the excess over \$321,450
Over \$408,200 but not over \$612,350	\$93,257 plus 35% of the excess over \$408,200
Over \$612,350	\$164,709.50 plus 37% of the excess over \$612,350

If taxable income is:	Then income tax equals:
<i>Married Individuals Filing Separate Returns</i>	
Not over \$9,700	10% of the taxable income
Over \$9,700 but not over \$39,475	\$970 plus 12% of the excess over \$9,700
Over \$39,475 but not over \$84,200	\$4,543 plus 22% of the excess over \$39,475
Over \$84,200 but not over \$160,725	\$14,382.50 plus 24% of the excess over \$84,200
Over \$160,725 but not over \$204,100	\$32,748.50 plus 32% of the excess over \$160,725
Over \$204,100 but not over \$306,175	\$46,628.50 plus 35% of the excess over \$204,100
Over \$306,175	\$82,354.75 plus 37% of the excess over \$306,175
<i>Estates and Trusts</i>	
Not over \$2,600	10% of the taxable income
Over \$2,600 but not over \$9,300	\$260 plus 24% of the excess over \$2,600
Over \$9,300 but not over \$12,750	\$1,868 plus 35% of the excess over \$9,300
Over \$12,750	\$3,075.50 plus 37% of the excess over \$12,750

Simplification of tax on unearned income of children.—Special rules (generally referred to as the “kiddie tax”) apply to the net unearned income of certain children.<sup>20</sup> Under prior law, the kiddie tax with respect to a child was generally calculated by reference to the allocable parental tax, the hypothetical increase in tax to the parent that results from adding the net unearned income of all applicable children of the parent to the parent’s taxable income and allocating the increase in tax liability proportionately among the children. The 2017 Tax Act simplifies the kiddie tax calculation, separating the child’s tax from the tax situation of the child’s parent and any of the child’s siblings, and subjecting the net unearned income of applicable children to tax under the tax rate schedule for trusts and estates.<sup>21</sup>

Deduction for qualified business income.—The 2017 Tax Act introduces a new deduction for qualified businesses income.<sup>22</sup> Individuals claim this deduction as part of the calculation of taxable income. Both taxpayers who take the standard deduction and those who itemize may claim the deduction. The deduction is discussed in depth below.

<sup>20</sup> Sec. 1(g).

<sup>21</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11001.

<sup>22</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 110011, enacting sec. 199A.

Excess farm loss and business loss limitations.—The 2017 Tax Act introduces a new limitation on excess business losses of taxpayers other than a corporation.<sup>23</sup> An excess business loss for a tax year is the excess of aggregate deductions of the taxpayer attributable to trades or business of the taxpayer (determined without regard to the limitations of the provision), over the sum of aggregate gross income or gains attributable to trades or businesses of the taxpayer plus a threshold amount.<sup>24</sup> The disallowed excess business loss is treated as a net operating loss (“NOL”) for the tax year for purposes of determining any NOL carryover to subsequent tax years. In addition, the 2017 Tax Act suspends the limitation on excess farm losses.

Increase in standard deduction.—The 2017 Tax Act increases the basic standard deduction.<sup>25</sup> In 2019, the standard deduction is \$24,400 for a joint return and a surviving spouse (increased from \$12,700 in 2017), \$18,350 for a head of household (increased from \$9,350 in 2017), and \$12,200 for other individuals (increased from \$6,350 in 2017).

Increase in and modification of child tax credit.—Individual taxpayers may claim the child tax credit (“CTC”), a credit of a fixed dollar amount for each qualifying child of the taxpayer.<sup>26</sup> Generally, a qualifying child is any individual under the age of 17 who is the taxpayer’s son, daughter, stepson, stepdaughter, adopted child, foster child, brother, sister, stepbrother, stepsister, or a descendant of any such individual. The child must share the same principal place of abode as the taxpayer for more than half of the taxable year, may not have provided over half of his or her own support for the taxable year, and may not file a joint return with a spouse.

The aggregate CTC is phased out for taxpayers with income over certain threshold amounts. To the extent the amount of the CTC exceeds the taxpayer’s tax liability, the taxpayer is eligible for a refundable credit (the “additional child tax credit”) equal to 15 percent of earned income in excess of a threshold amount. A taxpayer with three or more qualifying children may take the additional child tax credit in the amount by which the taxpayer’s Social Security taxes exceed the taxpayer’s earned income tax credit, if that amount is greater than the additional child tax credit based on the taxpayer’s earned income.

The 2017 Tax Act increases the amount of the CTC to \$2,000 per qualifying child (from \$1,000 in 2017), increases the maximum additional child tax credit to \$1,400, indexed for inflation up to \$2,000 (from \$1,000 in 2017), and lowers the threshold amount under the earned income formula to \$2,500 (from \$3,000 in 2017).<sup>27</sup> It also increases the phaseout threshold to \$400,000 in the case of a joint return and \$200,000 for all other taxpayers (increased from \$110,000 for joint returns, \$75,000 for single individuals or heads of households, and \$55,000

---

<sup>23</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11012.

<sup>24</sup> The threshold amount is indexed for inflation. The amount is \$255,000 for 2019.

<sup>25</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11021.

<sup>26</sup> Sec. 24.

<sup>27</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11022.

for married individuals filing separate returns in 2017). Finally, the 2017 Tax Act imposes a requirement that the taxpayer include a valid SSN for each qualifying child in order for such child to be taken into account for purposes of the CTC. For purposes of the SSN requirement, only SSNs that are issued to (1) citizens or (2) noncitizens for work authorization purposes are valid.<sup>28</sup>

Other dependent tax credit.—The 2017 Tax Act provides a new nonrefundable credit for other dependents (“ODTC”).<sup>29</sup> The ODTC is a credit of \$500 for each dependent of the taxpayer other than a qualifying child for purposes of the CTC. Thus, an eligible dependent generally is either (i) a qualifying child age 17 or 18 or a student under the age of 24, or (ii) a qualifying relative. A qualifying relative is an individual with a specified relationship to the taxpayer or an individual who has the same principal place of abode as the taxpayer and is a member of the taxpayer’s household. The individual’s gross income must be less than an exemption amount, the taxpayer must provide over one-half of the individual’s support for the tax year, and the individual generally must be a citizen, national, or resident of the United States. Additionally, a qualifying child that is not taken into account for purposes of the CTC due to the CTC SSN requirement may qualify as a dependent for purposes of the ODTC.

Modifications to the deduction for charitable contributions.—Individual taxpayers may claim a deduction for contributions to certain organizations, including charities.<sup>30</sup> Charitable contributions by individuals are limited to a specified percentage of the taxpayer’s contribution base. The contribution base is the taxpayer’s AGI for a tax year, disregarding any net operating loss carryback to the year under section 172. The specified percentage varies depending on the nature of the contribution and the identity of the donee. The 2017 Tax Act increases the specified percentage for charitable contributions of cash to an organization described in section 170(b)(1)(A) from 50 percent to 60 percent.<sup>31</sup>

Increased contributions to ABLE accounts.—A qualified ABLE program is a program established and maintained by a State or agency or instrumentality thereof.<sup>32</sup> Under the provisions of the program, contributions may be made to an account (an “ABLE account”) established for the purpose of meeting the qualified disability expenses of a designated beneficiary of the account. Contributions to an ABLE account must be made in cash and are not deductible for Federal income tax purposes. Contributions may not exceed a contribution amount equal to the gift tax annual exclusion. The 2017 Tax Act increases the contribution

---

<sup>28</sup> This requirement is also discussed in part IV.F of this document.

<sup>29</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11022.

<sup>30</sup> Sec. 170.

<sup>31</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11023.

<sup>32</sup> Sec. 529A.

limitation with respect to contributions made by the designated beneficiary.<sup>33</sup> Under the provision, the designated beneficiary may contribute to the ABLE account an amount each year, without regard to the annual exclusion limitation, up to the lesser of (1) the Federal poverty line for a one-person household or (b) the designated beneficiary's compensation<sup>34</sup> for the taxable year. The 2017 Tax Act also allows a designated beneficiary to claim the saver's tax credit for contributions made to the ABLE account.<sup>35</sup>

Rollovers to ABLE programs from 529 programs.—A qualified tuition program includes a program established and maintained by a State or agency or instrumentality thereof under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (often referred to as a “529 account”).<sup>36</sup> The 2017 Tax Act allows for amounts from 529 accounts to be rolled over to an ABLE account without penalty, provided that the ABLE account is owned by the designated beneficiary of that 529 account, or a member of such designated beneficiary's family.<sup>37</sup> Such rolled-over amounts count toward the contribution limitation of the ABLE account.

Treatment of certain individuals performing services in the Sinai Peninsula of Egypt.—Members of the Armed Forces serving in a combat zone are afforded a number of tax benefits. The 2017 Tax Act identifies the Sinai Peninsula of Egypt as a “qualified hazardous duty area” that is to be treated in the same manner as a combat zone for purposes of determining eligibility for the benefits available to members of the Armed Forces.<sup>38</sup>

Treatment of student loans discharged on account of death or disability.—An individual taxpayer's gross income generally includes the discharge of indebtedness. Under an exception to this general rule, gross income does not include any amount from the forgiveness of certain student loans, provided that the forgiveness is contingent on the student's working for a certain period of time in certain professions for any of a broad class of employers.<sup>39</sup> The 2017 Tax Act modifies the exclusion by expanding it to include the discharge of certain student loans on account of the death or total and permanent disability of the student.<sup>40</sup>

---

<sup>33</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11024.

<sup>34</sup> The term “compensation” is defined in section 219(f)(1).

<sup>35</sup> See sec. 25B.

<sup>36</sup> Sec. 529.

<sup>37</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11025.

<sup>38</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11026.

<sup>39</sup> Sec. 108(f).

<sup>40</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11031.

Suspension of deductions for personal exemptions.—An individual taxpayer may claim a deduction for personal exemptions for the taxpayer (both taxpayers in the case of a joint return) and any dependents of the taxpayer. In 2017, the personal exemption deduction amount was \$4,050. The 2017 Tax Act suspends the personal exemption by setting the amount deductible for each personal exemption to zero.<sup>41</sup>

Limitation of deduction for State and local taxes.—An individual taxpayer may claim an itemized deduction for certain taxes paid or accrued, whether or not incurred in a taxpayer's trade or business or activity for the production of income. These taxes are: (i) State, local, and foreign real property taxes; (ii) State and local personal property taxes; and (iii) State, local, and foreign income, war profits, and excess profits taxes. Taxpayers may deduct State and local sales taxes in lieu of income taxes. The 2017 Tax Act limits the aggregate amount of the deduction to \$10,000 (\$5,000 for a married taxpayer filing a separate return) in the case of: (i) State and local real property taxes; (ii) State and local personal property taxes; and (iii) State and local income, war profits, and excess profits taxes (or sales taxes in lieu of income taxes). It also suspends the deduction for foreign real property taxes.<sup>42</sup>

Limitation on deduction for qualified residence interest.—An individual taxpayer may deduct qualified residence interest, which is not treated as personal interest.<sup>43</sup> Under prior law, qualified residence interest included interest paid or accrued on up to a \$1 million of acquisition indebtedness (\$500,000 in the case of a married person filing a separate return) and on up to \$100,000 of home equity indebtedness (\$50,000 in the case of a married person filing a separate return). The 2017 Tax Act reduces the maximum amount treated as acquisition indebtedness to \$750,000 (\$350,000 in the case of a married person filing a separate return) and suspends the deduction for interest on home equity indebtedness.<sup>44</sup> However, in the case of acquisition indebtedness incurred before December 15, 2017, the prior law maximum amount applies.

Modification of deduction for personal casualty losses.—An individual taxpayer may claim an itemized deduction for personal casualty losses only if such losses exceed \$100 per casualty, and only to the extent that aggregate net casualty losses exceed 10 percent of the individual taxpayer's adjusted gross income. The 2017 Tax Act modifies this deduction, allowing a taxpayer to claim an itemized deduction for a personal casualty loss (subject to the limitations just described) only if such loss was attributable to a disaster declared by the President under section 401 of the Robert T. Stafford Disaster Relief and Emergency Assistance Act.<sup>45</sup>

---

<sup>41</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11041.

<sup>42</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11042.

<sup>43</sup> Sec. 163(h).

<sup>44</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11043.

<sup>45</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11044.

Suspension of miscellaneous itemized deductions.—An individual taxpayer may deduct certain expenses (“miscellaneous itemized deductions”) only if, in the aggregate, such expenses exceed two percent of the taxpayer’s adjusted gross income. Examples of miscellaneous itemized deductions include unreimbursed employee expenses (such as uniforms, union dues, and business-related meals and travel), deductions for tax preparation fees, and investment expenses (such as investment management fees, safe deposit box fees, and investment expenses from pass-through entities). The 2017 Tax Act suspends miscellaneous itemized deductions.<sup>46</sup>

Suspension of overall limitation on itemized deductions.—Under prior law, the total amount of most otherwise allowable itemized deductions was limited for certain upper-income individual taxpayers.<sup>47</sup> The 2017 Tax Act suspends this limitation.<sup>48</sup>

Suspension of exclusion for qualified bicycle commuting reimbursement.—Under prior law, certain qualified bicycle commuting reimbursements were excluded from gross income.<sup>49</sup> Reimbursements excluded from gross income for income tax purposes were also excluded from wages for employment tax purposes. The 2017 Tax Act suspends this exclusion from gross income and wages.<sup>50</sup>

Suspension of exclusion for qualified moving expense reimbursement.—Under prior law, certain qualified moving expenses reimbursements were excluded from gross income.<sup>51</sup> Reimbursements excluded from gross income for income tax purposes were also excluded from wages for employment tax purposes. The 2017 Tax Act repeals this exclusion from gross income and wages, except in the case of a member of the Armed Forces of the United States on active duty who moves pursuant to a military order and incident to a permanent change of station.<sup>52</sup>

Suspension of deduction for moving expenses.—Under prior law, an individual taxpayer could claim, in computing adjusted gross income, a deduction for moving expenses paid or incurred during the tax year in connection with the commencement of work as an employee or as

---

<sup>46</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11045.

<sup>47</sup> Sec. 68.

<sup>48</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11046.

<sup>49</sup> Sec. 132(a)(5), 132(f)(1)(D).

<sup>50</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11047.

<sup>51</sup> Sec. 132(a)(6), 132(g).

<sup>52</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11048.

a self-employed individual at a new principal place of work.<sup>53</sup> The 2017 Tax Act suspends this deduction.<sup>54</sup>

**Limitation on wagering losses.**—An individual taxpayer may claim a deduction for wagering losses sustained during the tax year only to the extent of the gains during the tax year for such transactions. The 2017 Tax Act clarifies that this limitation on losses applies not only to the actual costs of wagers incurred by an individual taxpayer, but to other expenses incurred by the individual taxpayer in connection with the conduct of his or her gambling activity.<sup>55</sup>

**Increase in alternative minimum tax exemption for individuals.**—The 2017 Tax Act increases the exemption amounts and the exemption amount phase out thresholds for the individual AMT such that fewer individual taxpayers will be subject to the individual AMT.<sup>56</sup> For 2019, the exemption amount is \$111,700 for married individuals filing jointly and surviving spouses (from \$84,500 in 2017), \$71,700 for other unmarried individuals (from \$54,300 in 2017), and \$55,850 for married individuals filing separately (from \$42,250 in 2017). The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds \$1,020,600 for married individuals filing jointly and surviving spouses (from \$160,900 in 2017), and \$510,300 for other individuals (from \$120,700 in the case of unmarried individuals other than surviving spouses and \$80,450 for married persons filing separate returns in 2017). These amounts are indexed annually for inflation.

## **Income taxation of trusts and estates**

### **Overview**

In general, estates and most trusts pay tax on income at the entity level to the extent that the income is not distributed or required to be distributed under governing law or under the terms of the governing instrument.<sup>57</sup> Such entities determine their tax liability using a special tax rate schedule and are subject to the alternative minimum tax. Certain trusts do not pay any Federal income tax at the entity level, for example trusts that distribute all income currently to beneficiaries. Other trusts are treated as being owned by grantors in whole or in part for tax purposes; in such cases, the grantors are taxed on the income of the trust.<sup>58</sup>

---

<sup>53</sup> Sec. 217.

<sup>54</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11049.

<sup>55</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11050.

<sup>56</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 12003.

<sup>57</sup> Sec. 651, sec 661.

<sup>58</sup> Sec. 671.

The income tax liability of trust and estates is generally calculated in the same way as that of individuals, subject to certain exceptions and modifications.<sup>59</sup>

### Changes Made by the 2017 Tax Act

Many of the provisions of the 2017 Tax Act that changed the taxation of individuals also changed the taxation of trusts and estates, effective for tax years beginning before January 1, 2026:

The 2017 Tax Act replaces the existing rate structure for trusts and estates with a new rate structure that reduces tax rates.<sup>60</sup> Trusts and estates may claim the new qualified business income deduction,<sup>61</sup> discussed more below. Trusts and estates were subject to the limitation on excess farm losses, now suspended and are now subject to the subject to the new excess business loss limitation,<sup>62</sup> the limit on the aggregate amount of the deduction for State and local taxes,<sup>63</sup> the limit on the personal casualty loss deduction,<sup>64</sup> and the suspension of miscellaneous itemized deductions.<sup>65</sup>

### **Qualified business income deduction**

Individual taxpayers, trusts, and estates generally may deduct 20 percent of qualified business income from a partnership, S corporation, or sole proprietorship, as well as 20 percent of aggregate qualified real estate investment trust (“REIT”) dividends and qualified publicly traded partnership income. A specified agricultural or horticulture cooperative generally may deduct nine percent of qualified production activities income.<sup>66</sup>

---

<sup>59</sup> Sec. 641(b).

<sup>60</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11001.

<sup>61</sup> Sec. 199A.

<sup>62</sup> Sec. 461(l)(1).

<sup>63</sup> Sec. 164, sec. 641(b).

<sup>64</sup> Sec. 165, sec. 641(b).

<sup>65</sup> Sec. 67, sec. 641(b).

<sup>66</sup> The deduction is limited by the cooperative’s taxable income for the year (computed without regard to the 199A deduction, and reduced by certain payments or allocations to patrons). The deduction may instead be allocated to and deducted by the cooperative’s patrons, limited to each patron’s taxable income for the year (computed without regard to any section 199A deduction under the general rule, and after taking into account the cooperative’s section 199A deduction).

For taxpayers with taxable income<sup>67</sup> in excess of a threshold amount,<sup>68</sup> the deduction with respect to qualified business income is limited based on (1) the taxpayer's allocable share of W-2 wages paid by the trade or business and the taxpayer's allocable share of capital investment with respect to the trade or business<sup>69</sup> and (2) the type of trade or business in which the income is earned.<sup>70</sup> These limitations begin to phase in above the threshold amount of taxable income. In addition, the deduction calculated with respect to qualified business income, qualified REIT dividends, and qualified publicly traded partnership income may not exceed 20 percent of the taxpayer's taxable income for the tax year.<sup>71</sup>

## **Estate and gift taxation**

### Overview

The United States generally imposes a gift tax on any transfer of property by gift made by a U.S. citizen or resident, whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. The gift tax is imposed on the donor and is based on the fair market value of the property transferred. Deductions are allowed for certain gifts to spouses and charities. Annual gifts up to an annual exclusion made by the donor to any person generally are not subject to tax.<sup>72</sup>

An estate tax also is imposed on the taxable estate of any person who was a citizen or resident of the United States at the time of death and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death. The

---

<sup>67</sup> Taxable income is computed without regard to the deduction allowable under section 199A with respect to the threshold amount.

<sup>68</sup> The threshold amounts are indexed for inflation. For 2019 the amount is \$321,400 for married taxpayers filing joint returns, \$160,725 for married taxpayers filing separate returns, and \$160,700 for all other taxpayers.

<sup>69</sup> The deduction is limited to the greater of (a) 50 percent of the W-2 wages paid with respect to the qualified trade or business, or (b) the sum of 25 percent of the W-2 wages with respect to the qualified trade or business plus 2.5 percent of the unadjusted basis, immediately after acquisition, of all qualified property. Sec. 199A(b)(2)(B).

<sup>70</sup> Qualified business income generally excludes income from a specified service trade or business when taxable income is in excess of the threshold amount, and always excludes income from the trade or business of performing services as an employee. A specified service trade or business means any trade or business involving the performance of services in the fields of health, law, accounting, actuarial science, performing arts, consulting, athletics, financial services, brokerage services, or any trade or business where the principal asset of such trade or business is the reputation or skill of one or more of its employees or owners, or which involves the performance of services that consist of investing and investment management, trading, or dealing in securities, partnership interests, or commodities. Sec. 199A(d).

<sup>71</sup> For this purposes, taxable income is computed without regard to the deduction allowable under section 199A and is reduced by net capital gain.

<sup>72</sup> The gift tax annual exclusion is indexed for inflation. In 2019, the annual exclusion is \$15,000.

estate tax is imposed on the estate of the decedent and generally is based on the fair market value of the property passing at death.<sup>73</sup> The taxable estate generally equals the worldwide gross estate less certain allowable deductions, including a marital deduction for certain bequests to the surviving spouse of the decedent and a deduction for certain bequests to charities.

The gift and estate taxes are unified such that a single graduated rate schedule and exemption apply to an individual's cumulative taxable gifts and bequests. The unified estate and gift tax rates begin at 18 percent on the first \$10,000 in cumulative taxable transfers and reach 40 percent on cumulative taxable transfers over \$1,000,000. A unified credit is available with respect to taxable transfers by gift or at death, which effectively exempts a basic exclusion amount in cumulative taxable transfers from the gift tax or the estate tax.<sup>74</sup> The unified credit generally also has the effect of rendering the marginal rates below 40 percent inapplicable. Unused exemption as of the death of a spouse generally is available for use by the surviving spouse; this feature of the law sometimes is referred to as exemption portability.

A separate transfer tax is imposed on generation-skipping transfers in addition to any estate or gift tax that is imposed on such transfers. This tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a beneficiary more than one generation below that of the transferor. The generation-skipping transfer tax is determined using a 40-percent rate and a basic exclusion amount.<sup>75</sup>

#### Changes made by the 2017 Tax Act

Prior to the enactment of the 2017 Tax Act, the basic exclusion amount was set at \$5 million for decedents dying and gifts made in 2011, and was indexed for inflation for years after 2011. The 2017 Tax Act generally temporarily doubles the estate and gift tax exemption.<sup>76</sup> This is accomplished by doubling the base year basic exclusion amount.<sup>77</sup> The base year basic exclusion amount is indexed for inflation occurring after 2011. For 2019, the basic exclusion

---

<sup>73</sup> In addition to interests in property owned by the decedent at the time of death, the Federal estate tax also is imposed on: (1) life insurance that was either payable to the decedent's estate or in which the decedent had an incident of ownership at death; (2) property over which the decedent had a general power of appointment at death; (3) annuities purchased by the decedent or his employer that were payable to the decedent before death; (4) certain interests in jointly held property; (5) property transferred by the decedent before death in which the decedent retained a life estate or over which the decedent had the power to designate who will possess or enjoy the property; (6) property revocably transferred by the decedent before death; and (7) certain transfers taking effect at the death of the decedent.

<sup>74</sup> Sec. 2010(c)(3)(B).

<sup>75</sup> The basic exclusion amount for the generation-skipping transfer tax is the same as the basic exclusion amount used to calculate the unified credit. Sec. 2631.

<sup>76</sup> The 2017 Tax Act, Pub. L. No. 115-97, sec. 11061.

<sup>77</sup> This amount, set forth in section 2010(c)(3), is increased from \$5 million to \$10 million.

amount is \$11.4 million (increased from \$5,490,000 in 2017).<sup>78</sup> This increased basic exclusion amount also applies for purposes of the generation-skipping transfer tax.

### **Description of Proposal**

The proposal makes permanent the temporary provisions of the 2017 Tax Act that changed the income taxation of individuals, the income taxation of trusts and estates, and estate and gift taxation.<sup>79</sup>

Effective date.—This proposal would generally be effective for taxable years beginning on or after January 1, 2026.

### **Analysis**

The primary purpose of a tax system is to raise revenue to fund government expenditures. Analysts generally judge a tax system in terms of how well the tax system handles issues of economic efficiency, fairness, and administrability. The design of a tax system involves tradeoffs between these different considerations. Measures designed to ensure compliance may increase the complexity of taxation for individual filers. Measures designed to promote simplicity may create distortions in investment decisions. Measures designed to promote growth may alter the distribution of the tax burden. The proposal to extend the 2017 Tax Act's provisions that relate to the individual income tax, income taxation of trusts and estates, and estate and gift tax generally affects all three of these issues.

Regarding economic efficiency, the proposal should generally increase economic activity by reducing tax rates on labor and increasing labor force participation. Joint Committee staff's analysis of the macroeconomic effects of the 2017 Tax Act predicts that the net effect of the changes to the individual income tax is to reduce average tax rates on wage income by about one percentage point, while reducing effective marginal tax rates on wages by about 2.5 percentage points until the expiration of the individual income tax provisions. Joint Committee staff's projected increase in the average level of output (as measured by Gross Domestic Product ("GDP")) over the 10-year budget window due to the 2017 Tax Act is driven in part by an increase in labor supply in response to the reduction in effective marginal tax rates on wages throughout most of the budget window. Extending the 2017 Tax Act's changes to the individual income tax should cause an increase in output by continuing this reduction in effective marginal tax rates on wages and subsequent increase in labor supply through the end of the budget window.

---

<sup>78</sup> As a conforming amendment to section 2001(g) (regarding computation of estate tax), the provision provides that the Secretary shall prescribe regulations as may be necessary or appropriate to carry out the purposes of the section with respect to differences between the basic exclusion amount in effect at the time of the decedent's death and at the time of any gifts made by the decedent.

<sup>79</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item I.

Turning to fairness, the proposal affects both horizontal equity—whether similarly situated individuals are taxed similarly—and vertical equity—whether individuals are taxed according to their ability to pay, *i.e.*, the level of progressivity.

As an example of how the proposal may affect horizontal equity, consider two families with the same economic income that differ on other dimensions such as number and age of children, size of mortgage, State and local taxes paid, or the amount of charitable contributions. If, under current law, one family chooses to itemize deductions and the other chooses the standard deduction, making the individual provisions permanent may increase the tax liability of the itemizing family because of limitations on itemized deductions and decrease the tax liability of the other by extending the increased standard deduction. Similarly, permanent extension of the changes to personal exemptions and the child tax credit may have different effects on families depending on the number of children under 17. The child tax credit will continue to be higher for children under 17, but for other dependents (*e.g.*, children aged 17, college-aged children, older relatives), the gain of the \$500 credit for other dependents may not be offset by the loss of the approximately \$4,000 personal exemption, depending on the marginal tax rate of the family.

Joint Committee staff constructs distributional tables to illustrate how policy changes may affect taxpayers differently across broad income categories, which can inform analysis of vertical equity. The individual tax changes of the 2017 Tax Act are estimated to generally reduce aggregate tax liability across income categories in 2019 through 2025 but raise aggregate tax liability across income categories in 2027.<sup>80</sup> The 2027 result is due to the expiration of the majority of changes to the individual income tax in the 2017 Tax Act, notably excluding the change in indexing from the Consumer Price Index for All Urban Consumers (“CPI-U”) to the Chained Consumer Price Index for All Urban Consumers (“C-CPI-U”) which generally results in aggregate increases in tax liability. Extending the 2017 Tax Act’s expiring individual income tax provisions should result in distributions in later years in the budget window that more closely resemble the distribution trends of 2019-2025.

Finally, regarding fairness, the proposal may simplify taxation for certain individual filers. Joint Committee staff estimates that the 2017 Tax Act reduced the number of taxpayers electing to itemize deductions from 48.7 million in 2017 to 20.4 million in 2018. For taxpayers who no longer itemize, changes to the individual income tax may have reduced the filing burden by making tax filing simpler. Similarly, Joint Committee staff estimates that the changes made by the 2017 Tax Act to the alternative minimum tax (“AMT”) reduced the number of taxpayers subject to the AMT from 4.7 million in 2017 to 0.2 million in 2018. The administrative burden is lower for taxpayers that no longer have to calculate tax liability under two different tax base and tax rate regimes. Extending the 2017 Tax Act’s changes to the individual income tax should continue this decreased tax filing burden on taxpayers through the end of the budget window.

The proposal permanently extends the estate and gift tax provisions enacted in the 2017 Tax Act which generally doubled the estate and gift tax exemption for estates of decedents dying

---

<sup>80</sup> Joint Committee on Taxation, *Distributional Effects of the Conference Agreement for H.R.1, the “Tax Cuts and Jobs Act”* (JCX-68-17), December 18, 2017.

and gifts made between 2018 and 2025. Transfer taxes such as the estate and gift taxes may affect economic efficiency by changing savings decisions, the composition of investment due to potential cash flow burdens on small or family owned businesses, labor supply decisions for eventual decedents and heirs, the distribution of wealth, and charitable bequests. Generally there is no consensus on the magnitude, or even direction in some cases, of some of these changes that would result from a decrease in taxes on transfers. For example, the increased exemptions may increase savings by lowering the after-tax cost of leaving a bequest, or may decrease savings by lowering the amount of savings necessary to achieve a certain size bequest goal. The proposal may make the tax system less progressive by exempting larger amounts from estate and gift taxes which generally only affect wealthy taxpayers, but arguably makes the tax system simpler as fewer taxpayers are subject to estate and gift taxes.

The individual income tax, income taxation of trusts and estates, and estate and gift tax provisions of the 2017 Tax Act are generally scheduled to expire for taxable years beginning after December 31, 2025. Scheduled future changes in tax policy may cause taxpayer uncertainty. To the extent that the past is indicative of future tax policy treatment, taxpayers may expect that certain aspects of the 2017 Tax Act's changes to the individual income tax will remain after 2025. The individual provisions of other major tax bills such as the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and the Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA") were scheduled to expire at the end of 2010, but were extended for two years. The 2012 American Taxpayer Relief Act ("ATRA") made many of these tax provisions permanent but allowed certain rate cuts affecting high-income taxpayers to expire.

Making the individual provisions of the 2017 Tax Act permanent may also change planning opportunities. For example, individuals with foresight may have planned to shift labor effort into the timeframe when marginal tax rates are temporarily lower; this incentive is lessened if marginal tax rates are expected to continue to be lower. Businesses may also make different structuring decisions if the individual provisions are permanent. For example, section 199A may apply differently depending on where in a group of affiliated businesses items like machinery, employees, and debt are located, but there are costs associated with moving such items around an affiliated group. An affiliated group's assessment of whether to undertake the transaction costs associated with moving items around within a group is affected by whether section 199A is expected to provide merely a temporary benefit or a permanent benefit. Furthermore, the deduction provided by section 199A impacts the financial feasibility of business models that could give rise to the deduction, and its permanence (or lack thereof) affects investment decisions with respect to such businesses.

## PART II – HEALTH

The discussion below is based on our understanding that the President’s 2020 budget incorporates certain provisions of the Graham-Cassidy-Johnson-Heller health care legislation, which was introduced as an amendment in the nature of a substitute to H.R. 1628<sup>81</sup> (“Graham-Cassidy bill”). This discussion incorporates such provisions with other health proposals described in the President’s 2020 budget, and is generally limited to the tax provisions.<sup>82</sup>

### Present Law

#### Premium assistance credit

##### In general

A refundable tax credit (the “premium assistance credit”) is provided for eligible individuals and families to subsidize the purchase of health insurance plans through an American Health Benefit Exchange (“Exchange”), referred to as “qualified health plans.”<sup>83</sup> In general, advance payments with respect to the premium assistance credit are made during the year directly to the insurer, as discussed below. However, eligible individuals may choose to pay their total health insurance premiums without advance payments and claim the credit at the end of the taxable year.

Qualified health plans generally must meet certain requirements.<sup>84</sup> Special rules apply to certain qualified health plans, referred to as “catastrophic-only” qualified health plans, which are available only to individuals who are under age 30 or meet other specified requirements.<sup>85</sup> The premium assistance credit is not available with respect to catastrophic-only qualified health plans.<sup>86</sup> In addition, in the case of a qualified health plan that provides coverage for abortions

---

<sup>81</sup> American Health Care Act of 2017 (115<sup>th</sup> Congress).

<sup>82</sup> As used herein, the Affordable Care Act (or “ACA”) refers to the combination of the Patient Protection and Affordable Care Act (“PPACA”), Pub. L. No. 111-148, March 23, 2010, and the Healthcare and Education Reconciliation Act of 2010 (“HCERA”), Pub. L. No. 111-152, March 30, 2010.

<sup>83</sup> Sec. 36B. Under the PPACA, an American Health Benefit Exchange is a source through which individuals can purchase health insurance coverage.

<sup>84</sup> PPACA, secs. 1301 and 1302.

<sup>85</sup> PPACA, sec. 1302(e).

<sup>86</sup> Under the Public Health Service Act (“PHSA”) as amended by the ACA, health insurance must meet certain requirements. Section 1251 of the PPACA excepts certain health plans sold at the time of enactment of the PPACA from some of the PHSA requirements (referred to as “grandfathered” plans). In addition, under guidance provided by the Center for Consumer Information & Insurance Oversight (“CCIIO,” part of the Department of Health and Human Services (“HHS”)), including a letter dated November 14, 2013, to the State Insurance Commissioners and subsequent extensions, certain health plans that were sold in the individual insurance market as of January 1, 2013, are permitted to be sold after January 1, 2014, despite not complying with ACA requirements

for which Federal funds may not be used, no part of the premium assistance credit may be used for the portion of premiums attributable to that coverage.<sup>87</sup>

The premium assistance credit is generally available for individuals (single or joint filers) with household incomes between 100 percent and 400 percent of the Federal poverty level (“FPL”) for the family size involved.<sup>88</sup> Household income is defined as the sum of (1) the individual’s modified adjusted gross income, plus (2) the aggregate modified adjusted gross incomes of all other individuals taken into account in determining the individual’s family size (but only if the other individuals are required to file a tax return for the taxable year). Modified adjusted gross income is defined as adjusted gross income increased by (1) any amount excluded from gross income for citizens or residents living abroad,<sup>89</sup> (2) any tax-exempt interest received or accrued during the tax year, and (3) the portion of the individual’s social security benefits not included in gross income.<sup>90</sup> To be eligible for the premium assistance credit, individuals who are married must file a joint return. Individuals who are listed as dependents on a return are not eligible for the premium assistance credit.

An individual who is eligible for minimum essential coverage from a source other than the individual insurance market generally is not eligible for the premium assistance credit.<sup>91</sup> However, an individual who is offered minimum essential coverage under an employer-sponsored health plan may be eligible for the premium assistance credit if an employee’s share of the premium for self-only coverage exceeds 9.86 percent (for 2019) of the employee’s household income, or the plan’s share of total allowed costs of benefits provided under the plan is less than 60 percent of such costs (called “minimum value”), and the individual declines the employer-offered coverage. An individual who enrolls in an employer-sponsored health plan generally is ineligible for the premium assistance credit, even if the coverage is considered unaffordable or does not provide minimum value.

As part of the process of enrollment in a qualified health plan through an Exchange, an individual may apply and be approved for advance payments with respect to a premium assistance credit (“advance payments”).<sup>92</sup> The individual must provide information on income,

---

(referred to as “grandmothered” plans). The premium assistance credit is not available with respect to a grandfathered plan or a grandmothered plan.

<sup>87</sup> PPACA, sec. 1303(b)(2).

<sup>88</sup> Federal poverty level refers to the most recently published poverty guidelines determined by the Secretary of HHS. Levels for 2019 and previous years are available at <https://aspe.hhs.gov/prior-hhs-poverty-guidelines-and-federal-register-references>.

<sup>89</sup> Sec. 911.

<sup>90</sup> Under section 86, only a portion of an individual’s social security benefits are included in gross income.

<sup>91</sup> Minimum essential coverage is defined in section 5000A(f).

<sup>92</sup> PPACA, Secs. 1411-1412. Under section 1402 of the PPACA, certain individuals eligible for advance premium assistance payments are eligible also for a reduction in their share of medical costs, such as deductibles and copays, under the plan, referred to as reduced cost-sharing. Eligibility for reduced cost-sharing is also determined as

family size, changes in marital or family status or income, and citizenship or lawful presence status.<sup>93</sup> Eligibility for advance payments is generally based on the individual's income for the tax year ending two years prior to the enrollment period. The Exchange process includes a system through which information provided by the individual is verified using information from the Internal Revenue Service ("IRS") and certain other sources.<sup>94</sup> If an individual is approved for advance payments, the Treasury pays the advance amount directly to the issuer of the health plan in which the individual is enrolled. The individual then pays to the issuer of the plan the difference between the advance payment amount and the total premium charged for the plan.

### Amount of credit

The premium assistance credit amount is generally the lower of (1) the premium for the qualified health plan in which the individual or family enrolls and (2) the premium for the second lowest cost silver plan in the rating area where the individual resides, reduced by the individual's or family's share of premiums.<sup>95</sup> As shown in Table 1 below, an individual's or family's share of premiums is a certain percentage of household income. For 2019, the percentage is 2.08 percent for household income up to 133 percent of FPL and is determined on a sliding scale in a linear manner up to 9.86 percent as household income rises from 133 percent of FPL to 400 percent of FPL.

---

part of the Exchange enrollment process. The Department of HHS is responsible for rules relating to Exchanges and the eligibility determination process.

<sup>93</sup> Under section 1312(f)(3) of the PPACA, an individual may not enroll in a qualified health plan through an Exchange if the individual is not a citizen or national of United States or an alien lawfully present in the United States. Thus, such an individual is not eligible for the premium assistance credit.

<sup>94</sup> Under section 6103, returns and return information are confidential and may not be disclosed, except as authorized by the Code, by the IRS, other Federal employees, State employees, and certain others having access to such information. Under section 6103(l)(21), upon written request of the Secretary of HHS, the IRS is permitted to disclose certain return information for use in determining an individual's eligibility for advance premium assistance payments, reduced cost-sharing, or certain other State health subsidy programs, including a State Medicaid program under title XIX of the Social Security Act, a State's Children's Health Insurance Program under title XXI of the Social Security Act and a Basic Health Program under section 1331 of the PPACA.

<sup>95</sup> The premium assistance amount is determined on a monthly basis and the credit for a year is the sum of the monthly amounts.

**Table 1.—Individual’s Share of Premiums  
(for 2019)<sup>96</sup>**

<b>Household income (expressed as a percent of FPL)</b>	<b>Initial percentage of household income</b>	<b>Final percentage of household income</b>
100% up to 133%	2.08	2.08
133% up to 150%	3.11	4.15
150% up to 200%	4.15	6.54
200% up to 250%	6.54	8.36
250% up to 300%	8.36	9.86
300% up to 400%	9.86	9.86

Reconciliation of advance payment on return

An individual on whose behalf advance payments of the premium assistance credit for a taxable year are made is required to file an income tax return to reconcile the advance payments with the credit to which the individual is entitled for the taxable year.<sup>97</sup>

If the advance payments of the premium assistance credit exceed the amount of credit to which the individual is entitled, the excess (“excess advance payments”) is treated as an

---

<sup>96</sup> Rev. Proc. 2018-34, 2018-23 I.R.B. 748. The percentages are indexed to the excess of premium growth over income growth for the preceding calendar year. After 2018, if the aggregate amount of premium assistance credits (and cost-sharing reductions under section 1402 of the PPACA) exceeds 0.504 percent of the gross domestic product for that year, the percentage of household income is also adjusted to reflect the excess (if any) of premium growth over the rate of growth in the consumer price index for the preceding calendar year. Such an adjustment was not required for 2019.

<sup>97</sup> Under section 6055, health insurance issuers are required to report to the IRS and to an individual the months during a year for which the individual was covered by minimum essential coverage issued by the insurer in the individual market. In addition, under section 36B(f)(3), an Exchange is required to report to the IRS and to an individual the months during a year for which the individual was covered by a qualified health plan purchased through the Exchange, the premiums paid by the individual, and, if applicable, advance premium assistance payments made on behalf of the individual.

additional tax liability on the individual’s income tax return for the taxable year (referred to as “recapture”), subject to a limit on the amount of additional liability in some cases. For an individual with household income below 400 percent of FPL, liability for the excess advance payments for a taxable year is limited to a specific dollar amount (the “applicable dollar amount”) as shown in Table 2 below. One-half of the applicable dollar amount shown in Table 2 applies to an unmarried individual who is not a surviving spouse or filing as a head of household.

**Table 2.—Reconciliation Limit on Additional Tax Liability  
(for 2019)<sup>98</sup>**

<b>Household income (expressed as a percent of FPL)</b>	<b>Applicable dollar amount</b>
Less than 200%	\$600
At least 200% but less than 300%	\$1,600
At least 300% but less than 400%	\$2,650

If the advance payments of the premium assistance credit for a taxable year are less than the amount of the credit to which the individual is entitled, the additional credit amount is also reflected on the individual’s income tax return for the year.

**Employer shared responsibility**

In general

An applicable large employer, as defined below, may be subject to a tax, called an “assessable payment,” for a month if one or more of its full-time employees is certified to the employer as receiving for the month a premium assistance credit or reduced cost-sharing with respect to health insurance purchased through an Exchange (commonly referred to as the “employer mandate”).<sup>99</sup> As discussed below, the amount of the assessable payment depends on whether the employer offers its full-time employees and their dependents the opportunity to

---

<sup>98</sup> Rev. Proc. 2018-57, 2018-49 I.R.B. 827. The applicable dollar amounts are indexed to reflect cost-of-living increases, with the amount of any increase rounded down to the next lowest multiple of \$50.

<sup>99</sup> Sec. 4980H. As discussed above, premium assistance credits under section 36B apply with respect to health insurance purchased through an Exchange. An employer may also be subject to an assessable payment if an employee received reduced cost-sharing with respect to coverage purchased through an Exchange as discussed above.

enroll in minimum essential coverage under a group health plan sponsored by the employer and, if it does, whether the coverage offered is affordable and provides minimum value.

#### Definitions of applicable large employer and full-time employee

Applicable large employer generally means, with respect to a calendar year, an employer who employed an average of at least 50 full-time employees on business days during the preceding calendar year. For purposes of these rules, full-time employee means, with respect to any month, an employee who is employed on average at least 30 hours of service per week. Solely for purposes of determining whether an employer is an applicable large employer (that is, whether the employer has at least 50 full-time employees), besides the number of full-time employees, the employer must include the number of its full-time equivalent employees for a month, determined by dividing the aggregate number of hours of service of employees who are not full-time employees for the month by 120. In addition, in determining whether an employer is an applicable large employer, members of the same controlled group, group under common control, and affiliated service group are treated as a single employer.<sup>100</sup> If the group is an applicable large employer under this test, each member of the group is an applicable large employer even if any member by itself would not be an applicable large employer.

#### Assessable payments

If an applicable large employer does not offer its full-time employees and their dependents minimum essential coverage under an employer-sponsored plan and the employer receives certification with respect to at least one full-time employee as receiving a premium assistance credit or reduced cost-sharing, the employer may be subject to an assessable payment of \$2,500 (for 2019, divided by 12 and applied on a monthly basis) multiplied by the number of its full-time employees in excess of 30, regardless of the number of full-time employees so certified.

Generally an employee who is offered minimum essential coverage under an employer-sponsored plan is not eligible for a premium assistance credit or reduced cost-sharing unless the coverage is unaffordable or fails to provide minimum value.<sup>101</sup> However, if an employer offers its full-time employees and their dependents minimum essential coverage under an employer-sponsored plan and receives certification with respect to at least one full-time employee as receiving a premium assistance credit or reduced cost-sharing (because the coverage is unaffordable or fails to provide minimum value), the employer may be subject to an assessable payment of \$3,750 (for 2019, divided by 12 and applied on a monthly basis) multiplied by the number of the full-time employees who were so certified and eligible for the credit or reduced cost-sharing. However, the assessable payment in this case is capped at the amount that would

---

<sup>100</sup> The rules for determining controlled group, group under common control, and affiliated service group under sections 414(b), (c), (m) and (o) apply for this purpose.

<sup>101</sup> Coverage under an employer-sponsored plan is unaffordable if the employee's share of the premium for self-only coverage exceeds 9.86 (for 2019) percent of household income, and the coverage fails to provide minimum value if the plan's share of total allowed cost of provided benefits is less than 60 percent of such costs.

apply if the employer failed to offer its full-time employees and their dependents minimum essential coverage.

## **Health savings accounts and high deductible health plans**

### Health savings accounts

In general, a health savings account (“HSA”) is a tax-exempt trust or custodial account created exclusively to pay for the qualified medical expenses of the account holder and his or her spouse and dependents. 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.

An individual may establish an HSA only if the individual is covered under a plan that meets the requirements for a high deductible health plan, as described below. After an individual has attained age 65 and becomes entitled to Medicare benefits, contributions can no longer be made to the individual’s HSA.<sup>102</sup>

Within limits,<sup>103</sup> contributions to an HSA made by or on behalf of an eligible individual are deductible by the individual. Contributions to an HSA are excludible from income and employment taxes if made by the employer. Earnings in HSAs are not taxable. Distributions from an HSA for qualified medical expenses are not includible in gross income. Distributions from an HSA that are not used for qualified medical expenses are includible in gross income and are subject to an additional tax of 20 percent. The 20-percent additional tax does not apply if the distribution is made after death, disability, or the individual attains the age of Medicare eligibility (age 65). Similar rules apply for another type of medical savings arrangement called an Archer medical savings account (“Archer MSA”);<sup>104</sup> in addition, similar rules to apply to a type of Archer MSA designated as a “Medicare Advantage MSA”<sup>105</sup> to which contributions are made by the Secretary of HHS on behalf of the account holder.

---

<sup>102</sup> See sec. 223(b)(7), as interpreted by Notice 2004-2, 2004-2 I.R.B. 269, December 22, 2003, corrected by Announcement 2004-67, 2004-36 I.R.B. 459, September 7, 2004 (“After an individual has attained age 65 and becomes enrolled in Medicare benefits, contributions, including catch-up contributions, cannot be made to an individual’s HSA.”). See also Notice 2004-50, 2004-33 I.R.B. 1, August 9, 2004, Q&A-2 (“Thus, an otherwise eligible individual under section 223(c)(1) who is not actually enrolled in Medicare Part A or Part B may contribute to an HSA until the month that individual is enrolled in Medicare.”) and Notice 2008-59, 2008-29 I.R.B. 123, June 25, 2008, Q&A-5 and Q&A-6 (“[A]n individual is not an eligible individual under section 223(c)(1) in any month during which such individual is both eligible for benefits under Medicare and enrolled to receive benefits under Medicare,” including Part D (or any other Medicare benefit)).

<sup>103</sup> For 2019, the basic limit on annual contributions that can be made to an HSA is \$3,500 in the case of self-only coverage and \$7,000 in the case of family coverage. The basic annual contributions limits are increased by \$1,000 for individuals who have attained age 55 by the end of the taxable year (referred to as “catch-up” contributions).

<sup>104</sup> Sec. 220.

<sup>105</sup> Sec. 138.

### High deductible health plans

A high deductible health plan is a health plan that has an annual deductible which is not less than \$1,350 (for 2019) for self-only coverage and twice this amount for family coverage, and for which the sum of the annual deductible and other annual out-of-pocket expenses (other than premiums) for covered benefits does not exceed \$6,750 (for 2019) for self-only coverage and twice this amount for family coverage.<sup>106</sup> These dollar thresholds are subject to inflation adjustment, based on chained CPI.<sup>107</sup>

An individual who is covered under a high deductible health plan is eligible to establish an HSA, provided that while such individual is covered under the high deductible health plan, the individual is not covered under any health plan that (1) is not a high deductible health plan and (2) provides coverage for any benefit (subject to certain exceptions) covered under the high deductible health plan.<sup>108</sup>

Various types of coverage are disregarded for this purpose, including coverage of any benefit provided by permitted insurance, coverage (whether through insurance or otherwise) for accidents, disability, dental care, vision care, or long-term care, as well as certain limited coverage through health flexible savings accounts.<sup>109</sup> Permitted insurance means insurance under which substantially all of the coverage provided relates to liabilities incurred under workers' compensation laws, tort liabilities, liabilities relating to ownership or use of property, or such other similar liabilities as specified by the Secretary under regulations. Permitted insurance also means insurance for a specified disease or illness, and insurance paying a fixed amount per day (or other period) of hospitalization.<sup>110</sup>

Under a safe harbor, a high deductible health plan is permitted to provide coverage for preventive care (within the meaning of section 1861 of the Social Security Act, except as otherwise provided by the Secretary) before satisfaction of the minimum deductible.<sup>111</sup> IRS guidance provides a safe harbor of the types of coverage that constitute preventive care for this purpose.<sup>112</sup>

---

<sup>106</sup> Sec. 223(c)(2).

<sup>107</sup> Sec. 223(g).

<sup>108</sup> Sec. 223(c)(1).

<sup>109</sup> Sec. 223(c)(1)(B).

<sup>110</sup> Sec. 223(c)(3).

<sup>111</sup> Sec. 223(c)(2)(C).

<sup>112</sup> Notice 2004-23, 2004-15 I.R.B. 725, April 12, 2004. See also Notice 2004-50, 2004-33 IRB 1, August 9, 2004; Notice 2008-59, 2008-29 I.R.B. 123, July 21, 2008; Notice 2013-37, 2013-40 I.R.B. 293, September 30, 2013.

## **Deduction for expenses allocable to Medicare Part D subsidy**

Sponsors of qualified retiree prescription drug plans are eligible for subsidy payments from the Secretary of HHS with respect to a portion of each qualified covered retiree's gross covered prescription drug costs ("qualified retiree prescription drug plan subsidy").<sup>113</sup> A qualified retiree prescription drug plan is employment-based retiree health coverage that has an actuarial value at least as great as the Medicare Part D standard plan for the risk pool and that meets certain other disclosure and recordkeeping requirements. These qualified retiree prescription drug plan subsidies are excludible from the plan sponsor's gross income.<sup>114</sup>

In general, no deduction is allowed under any provision of the Code for any expense or amount that would otherwise be allowable as a deduction if the expense or amount is allocable to a class or classes of exempt income.<sup>115</sup> Thus, expenses incurred with respect to the subsidies excluded from income would generally not be deductible. For years before 2013, the exclusion for the qualified retiree prescription drug plan subsidy included a provision under which the exclusion was not taken into account in determining deductions with respect to the retiree prescription drug costs for which subsidy payments were received, thus allowing a deduction for costs subsidized by HHS payments. The ACA eliminated that provision and, as a result, the amount otherwise allowable as a deduction for retiree prescription drug costs is reduced by the amount of excludable subsidy payments received.

## **Distributions and reimbursements for over-the-counter medications**

### **Exclusion for employer-provided health benefits**

Employees may exclude from gross income the value of employer-provided health coverage under an accident or health plan.<sup>116</sup> In addition, any reimbursements under an employer-provided accident or health plan for medical care expenses for employees, their spouses, their dependents, and adult children under age 27 generally are excludible from gross income.<sup>117</sup>

An employer may agree to reimburse expenses for medical care of its employees (and their spouses, dependents, and adult children under age 27) not covered by a health insurance plan through a flexible spending arrangement ("FSA"), which allows reimbursement not in excess of a specified dollar amount, provided the amount is only available for reimbursement for medical care.<sup>118</sup> The amount available for reimbursement is either elected by an employee under a cafeteria plan ("health FSA") or otherwise specified by the employer under a health

---

<sup>113</sup> Sec. 1860D-22 of the Social Security Act (SSA), 42 U.S.C. sec. 1395w-132.

<sup>114</sup> Sec. 139A.

<sup>115</sup> Sec. 265(a) and Treas. Reg. sec. 1.265-1(a).

<sup>116</sup> Sec. 106.

<sup>117</sup> Sec. 105(b).

<sup>118</sup> Sec. 106(c)(1).

reimbursement arrangement (“HRA”). Reimbursements under these arrangements are also excludible from gross income as reimbursements for medical care under an employer-provided accident or health plan.

### Health savings accounts

As described above, distributions from an HSA or an Archer MSA that are used for qualified medical expenses are excludible from gross income. Distributions from an HSA or an Archer MSA that are not used for qualified medical expenses are includible in gross income and generally are subject to an additional tax of 20 percent.

### Medical care for excludible reimbursements

For purposes of the exclusion for reimbursements under employer-provided accident and health plans (including under health FSAs and HRAs), and for distributions from HSAs and Archer MSAs used for qualified medical expenses, the definition of medical care is generally the same as the definition that applies for the itemized deduction for the cost of medical care and includes prescription medicine or drugs and insulin.<sup>119</sup> However, the definition of medical care for purposes of the exclusion for reimbursements for medical care under employer-provided accident and health plans and for distributions from HSAs and Archer MSAs used for qualified medical expenses includes an over-the-counter medicine but only if prescribed by a physician.<sup>120</sup> Thus, excludible treatment under a health FSA or an HRA is available on reimbursements for the cost of over-the-counter medicine only if the medicine is prescribed by a physician, and distributions from an HSA or an Archer MSA used to purchase over-the-counter medicine are included in gross income and subject to an additional 20 percent tax unless the medicine is prescribed by a physician.

### Small business healthcare tax credit

#### In general

Present law provides a tax credit for an eligible small employer for up to 50 percent of the employer’s nonelective contributions to purchase health insurance for its employees. An eligible small employer for this purpose generally is an employer with no more than 25 full-time equivalent employees (“FTEs”) during the employer’s taxable year whose average annual wages (for 2019) do not exceed \$54,200.<sup>121</sup> The full amount of the credit is available only to an

---

<sup>119</sup> Sec. 213(d). There are certain limitations on the general definition including a rule that cosmetic surgery or similar procedures are generally not medical care.

<sup>120</sup> The prescription requirement does not apply to insulin.

<sup>121</sup> Wages for this purpose is defined as under the Federal Insurance Contributions Act (“FICA”), sections 3101-3128, without regard to the dollar limit on FICA wages under section 3121(a). The wage amounts relevant for purposes of the credit are indexed to the Consumer Price Index for Urban Consumers (“CPI-U”) for taxable years beginning after 2013 and before 2018, and chained CPI-U for taxable years beginning after 2017.

employer with 10 or fewer FTEs whose average annual wages do not exceed (for 2019) \$27,100, and is phased out based on the number of FTEs over 10 and average annual wages over \$27,100.

For purposes of the credit, the employer is determined by applying the aggregation rules for controlled groups, groups under common control, and affiliated service groups.<sup>122</sup> In addition, for purposes of the credit, the term “employee” includes a leased employee, that is, an individual who is not an employee of the employer, who provides services to the employer pursuant to an agreement between the employer and another person (a “leasing organization”) and under the primary direction or control of the employer, and who has performed such services on a substantially full-time basis for at least one year.<sup>123</sup>

Self-employed individuals (including partners and sole proprietors),<sup>124</sup> two-percent shareholders of an S Corporation,<sup>125</sup> and five-percent owners of the employer<sup>126</sup> are not employees for purposes of the credit with the result that they are disregarded in determining number of FTEs, average annual wages, and nonelective contributions for employees’ health insurance. Family members of these individuals and any member of the individual’s household who is a dependent for tax purposes are also not employees for purposes of the credit. In addition, the hours of service worked by and wages paid to a seasonal worker of an employer are not taken into account in determining number of FTEs and average annual wages unless the worker works for the employer on more than 120 days during the taxable year.

The employer contributions must be provided under an arrangement that requires the eligible small employer to make, on behalf of each employee who enrolls in qualifying health insurance offered by the employer, a nonelective contribution equal to a uniform percentage (not less than 50 percent) of the premium cost of the qualifying health insurance.<sup>127</sup> The credit is available only for nonelective contributions for premiums for insurance purchased through a Small Business Health Options (“SHOP”) Exchange and is available for a maximum credit period of two consecutive taxable years beginning with the first taxable year in which the employer (or any predecessor) offers coverage to its employees through a SHOP Exchange.<sup>128</sup>

---

<sup>122</sup> Sec. 414(b), (c), (m), and (o).

<sup>123</sup> Sec. 414(n)(2).

<sup>124</sup> Sec. 401(c).

<sup>125</sup> Sec. 1372(b).

<sup>126</sup> Five-percent owner is defined as for purposes of the qualified retirement plan top-heavy rules under section 416(i)(1)(B)(i).

<sup>127</sup> A nonelective contribution is an employer contribution other than an employer contribution pursuant to a salary reduction arrangement.

<sup>128</sup> The maximum two-year credit period does not take into account any taxable years beginning before 2014.

The credit is available only to offset actual tax liability (that is, it is not a refundable credit) and is claimed on the employer's tax return. The credit is a general business credit and generally can be carried back for one year and carried forward for 20 years. The dollar amount of the credit reduces the amount of employer contributions the employer may deduct as a business expense.

### Tax-exempt organizations

A tax-exempt organization<sup>129</sup> that otherwise qualifies as an eligible small employer is eligible to receive the small business healthcare tax credit. For tax-exempt organizations, the applicable credit percentage is limited to 35 percent. In addition, for tax-exempt organizations, instead of being a general business credit, the credit is a refundable credit limited to the amount of the payroll taxes of the employer during the calendar year in which the taxable year begins. For this purpose, "payroll taxes" means: (1) the amount of income tax required to be withheld from its employees' wages; (2) the amount of hospital insurance tax required to be withheld from its employees' wages; and (3) the amount of the hospital insurance tax imposed on the employer.<sup>130</sup>

### Medical device excise tax

Effective for sales after December 31, 2012, excluding sales during the period beginning on January 1, 2016 and ending on December 31, 2019, a tax equal to 2.3 percent of the sale price is imposed on the sale of any taxable medical device by the manufacturer, producer, or importer of such device.<sup>131</sup> A taxable medical device is any device, as defined in section 201(h) of the Federal Food, Drug, and Cosmetic Act,<sup>132</sup> intended for humans. Regulations further define a medical device as one that is listed by the Food and Drug Administration ("FDA") under section 510(j) of the Federal Food, Drug, and Cosmetic Act and 21 C.F.R. Part 807, pursuant to FDA requirements.<sup>133</sup>

---

<sup>129</sup> A tax-exempt organization is an organization described in section 501(c) that is exempt from tax under section 501(a).

<sup>130</sup> Secs. 3402, 3101(b), 3102, and 3111(b).

<sup>131</sup> Sec. 4191.

<sup>132</sup> 21 U.S.C. sec. 321. Section 201(h) defines device as "an instrument, apparatus, implement, machine, contrivance, implant, in vitro reagent, or other similar or related article, including any component, part, or accessory, which is (1) recognized in the official National Formulary, or the United States Pharmacopeia, or any supplement to them, (2) intended for use in the diagnosis of disease or other conditions, or in the cure, mitigation, treatment, or prevention of disease, in man or other animals, or (3) intended to affect the structure or any function of the body of man or other animals, and which does not achieve its primary intended purposes through chemical action within or on the body of man or other animals and which is not dependent upon being metabolized for the achievement of its primary intended purposes."

<sup>133</sup> Treas. Reg. sec. 48.4191-2(a). The regulations also include as devices items that should have been listed as a device with the FDA as of the date the FDA notifies the manufacturer or importer that corrective action with respect to listing is required.

The excise tax does not apply to eyeglasses, contact lenses, hearing aids, or any other medical device determined by the Secretary to be of a type that is generally purchased by the general public at retail for individual use (“retail exemption”). Regulations provide guidance on the types of devices that are exempt under the retail exemption. A device is exempt under these provisions if: (1) it is regularly available for purchase and use by individual consumers who are not medical professionals; and (2) the design of the device demonstrates that it is not primarily intended for use in a medical institution or office or by a medical professional.<sup>134</sup> Additionally, the regulations provide certain safe harbors for devices eligible for the retail exemption.<sup>135</sup>

The medical device excise tax is generally subject to the rules applicable to other manufacturers excise taxes. These rules include certain general manufacturers excise tax exemptions including the exemption for sales for use by the purchaser for further manufacture (or for resale to a second purchaser in further manufacture) or for export (or for resale to a second purchaser for export).<sup>136</sup> If a medical device is sold free of tax for resale to a second purchaser for further manufacture or for export, the exemption does not apply unless, within the six-month period beginning on the date of sale by the manufacturer, the manufacturer receives proof that the medical device has been exported or resold for use in further manufacturing.<sup>137</sup> In general, the exemption does not apply unless the manufacturer, the first purchaser, and the second purchaser are registered with the Secretary of the Treasury. Foreign purchasers of articles sold or resold for export are exempt from the registration requirement.

The lease of a medical device is generally considered to be a sale of such device.<sup>138</sup> Special rules apply for the imposition of tax to each lease payment. The use of a medical device subject to tax by manufacturers, producers, or importers of such device, is treated as a sale for the purpose of imposition of excise taxes.<sup>139</sup>

There are also rules for determining the price of a medical device on which the excise tax is imposed.<sup>140</sup> These rules provide for (1) the inclusion of containers, packaging, and certain transportation charges in the price, (2) determining a constructive sales price if a medical device

---

<sup>134</sup> Treas. Reg. sec. 48.4191-2(b)(2).

<sup>135</sup> Treas. Reg. sec. 48.4191-2(b)(2)(iii). The safe harbors include devices that are described as over-the-counter devices in relevant FDA classification headings as well as certain FDA device classifications listed in the regulations.

<sup>136</sup> Sec. 4221(a). Other general manufacturers excise tax exemptions (*i.e.*, the exemption for sales to purchasers for use as supplies for vessels or aircraft, to a State or local government, to a nonprofit educational organization, or to a qualified blood collector organization) do not apply to the medical device excise tax.

<sup>137</sup> Sec. 4221(b).

<sup>138</sup> Sec. 4217(a).

<sup>139</sup> Sec. 4218.

<sup>140</sup> Sec. 4216.

is sold for less than the fair market price, and (3) determining the tax due in the case of partial payments or installment sales.

### **Description of Proposals**

As described below, the President's 2020 budget includes several tax proposals related to healthcare, including certain provisions of the Graham-Cassidy bill with modified effective dates.<sup>141</sup>

#### **Modifications and repeal of premium assistance credit**

The proposal makes several modifications to the premium assistance credit for a transition period and repeals the premium assistance credit at the end of the transition period.<sup>142</sup>

##### **Minimum contribution for premium assistance credit eligibility**

The proposal requires an individual who is enrolled in a health plan on an Exchange and receiving a premium assistance credit to contribute a minimum percentage of the individual's income towards the cost of such a health plan. It accomplishes this by reducing the amount of the premium assistance credit (calculated as under present law) that would otherwise be available, to ensure that the out-of-pocket costs to the individual meet the required minimum percentage of income spent towards the health plan.

##### **Repeal of premium assistance credit**<sup>143</sup>

The proposal repeals the premium assistance credit for taxable years beginning after December 31, 2020.

---

<sup>141</sup> The estimated budgetary effect of these proposals can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item II.

<sup>142</sup> Other proposals in the President's 2020 budget that impact the premium assistance credit (until the end of the transition period when it is repealed) relate to the types of plans to which the premium assistance credit may apply and reducing the grace period to repay missed premium payments. Specifically, under section 102 of Graham-Cassidy bill, the premium assistance credit is not permitted with respect to a qualified health plan that includes coverage for abortions, other than an abortion necessary to save the life of the mother or an abortion with respect to a pregnancy that is the result of an act of rape or incest. In addition, the budget proposal reduces the grace period for repaying any missed premium payments for coverage in an Exchange health plan from 90 days to 30 days.

<sup>143</sup> The proposal generally also repeals the provisions of sections 1411 and 1412 of the PPACA relating to the determination of eligibility for advance premium assistance payments.

### **Repeal of employer shared responsibility penalty**<sup>144</sup>

The proposal reduces the amount of the assessable penalties under the employer mandate to zero. Thus, the proposal effectively repeals the employer mandate, effective for months beginning after December 31, 2018.

### **Modifications to health savings accounts and high deductible health plans**

The proposal makes several modifications to health savings accounts and high deductible health plans, as described below. These modifications are generally effective for taxable years beginning after December 31, 2020, unless otherwise indicated.

1. Treat health plans with an actuarial value of 70 percent or less as a high deductible health plan.
2. Deem all individual and small group market health plans which satisfy the PPACA out-of-pocket spending limit as satisfying the out-of-pocket limit applicable to HSAs.
3. Treat fees for direct primary care arrangements as qualified medical expenses for purposes of HSA distributions.
4. Decrease the tax on distributions from HSAs and Archer HSAs that are not qualified medical expenses to 10 percent and 15 percent, respectively.<sup>145</sup> This proposal is effective for taxable years beginning after December 31, 2019.
5. Treat amounts distributed from an HSA (which are not otherwise excluded, deductible, or provided a tax credit) that are applied towards the cost of a high deductible health plan as qualified medical expenses.<sup>146</sup>
6. Treat amounts distributed from an HSA with respect to a child under age 27 of the HSA account holder as qualified medical expenses (to the extent such amounts would otherwise be treated as such).<sup>147</sup>
7. Increase the contribution limit for HSAs to equal the maximum out-of-pocket limits for high deductible health plans.<sup>148</sup>

---

<sup>144</sup> Sec. 105 of Graham-Cassidy bill.

<sup>145</sup> Sec. 109 of Graham-Cassidy bill.

<sup>146</sup> Sec. 112 of Graham-Cassidy bill.

<sup>147</sup> Sec. 112 of Graham-Cassidy bill.

<sup>148</sup> Sec. 113 of Graham-Cassidy bill.

8. Permit the spouse of an account holder of an HSA (who would be otherwise eligible to make a catch-up contribution if age 55 or older) to also make a catch-up contribution (if age 55 or older) to the account holder's HSA.<sup>149</sup>
9. Treat otherwise eligible expenses that are incurred after coverage begins under a high deductible plan as qualified medical expenses if paid from an HSA established within 60 days after such coverage begins.<sup>150</sup>
10. Disallow treatment as qualified medical expenses of amounts distributed from an HSA that are applied towards a high deductible health plan that provides coverage for abortions (except if necessary to save the life of the mother or if the pregnancy is the result of an act of rape or incest).<sup>151</sup>
11. Permit an employee who is age 65 or older and covered under an employer high deductible health plan to contribute to an HSA, even if the individual is entitled to Medicare benefits.
12. Permit Medicare Advantage MSA account holders to make contributions to such MSA, based on the contribution limits applicable to HSAs, with a one-time opportunity to roll over funds from the individual's HSA account to the individual's Medicare Advantage MSA account. However, individuals who choose to make such contributions would not be permitted to purchase Medigap or other supplemental insurance.

### **Repeal of elimination of deduction for expenses allocable to Medicare Part D subsidy**

Under the proposal,<sup>152</sup> the exclusion for qualified retiree prescription drug plan subsidy payments is not taken into account in determining whether a deduction is allowed with respect to retiree prescription drug costs taken into account in determining the subsidy payments from HHS. Therefore, a taxpayer may claim a deduction for covered retiree prescription drug expenses notwithstanding that the taxpayer excludes from income qualified retiree prescription drug plan subsidies received from HHS with respect to the expenses. The proposal is effective for taxable years beginning after December 31, 2019.

---

<sup>149</sup> Sec. 114 of Graham-Cassidy bill.

<sup>150</sup> Sec. 115 of Graham-Cassidy bill.

<sup>151</sup> Sec. 116 of Graham-Cassidy bill.

<sup>152</sup> Sec. 111 of Graham-Cassidy bill.

## **Distributions and reimbursements for over-the-counter medications**

The proposal<sup>153</sup> changes the definition of qualified medical care for purposes of the exclusions for reimbursements for medical care under employer-provided accident and health plans (including health FSAs and HRAs) and for distributions from HSAs or Archer MSAs used for qualified medical expenses to include over-the-counter medicine (such as nonprescription aspirin, allergy medicine, antacids, or pain relievers) that is not prescribed by a physician. The proposal is effective for taxable years beginning after December 31, 2019.

## **Repeal of small business healthcare tax credit**

The proposal<sup>154</sup> repeals the small business healthcare tax credit for taxable years beginning after December 31, 2020.<sup>155</sup>

## **Repeal of medical device excise tax**

The proposal<sup>156</sup> repeals the medical device excise tax for sales after December 31, 2020. Thus, the medical device excise tax applies to sales after December 31, 2012 and before January 1, 2016, as well as sales during calendar year 2020.

## **Analysis**

Government intervention in the provision of health care is rationalized in several ways. Some view health care as a basic right. Others argue that the presence of both health externalities (healthy people are less likely to spread infectious diseases) and fiscal externalities (healthy people are more productive, pay more taxes, and receive less benefits) warrant government intervention.<sup>157</sup> The Federal government plays a significant role in the provision of health insurance in the United States through programs such as Medicaid and Medicare, which provide insurance for the poor and aged, and tax incentives such as the exclusion for employer-sponsored health coverage and the premium assistance credit, which subsidize individual health care costs.

---

<sup>153</sup> Sec. 108 of Graham-Cassidy bill.

<sup>154</sup> Sec. 103 of Graham-Cassidy bill.

<sup>155</sup> The proposal would disallow the small business healthcare tax credit with respect to a qualified health plan that includes abortion coverage for taxable years beginning after December 31, 2017, other than an abortion necessary to save the life of the mother or an abortion with respect to a pregnancy that is the result of an act of rape or incest. This provision could effectively preclude some small employers from having access to the credit for years after 2017, unless the SHOP Exchange in an employer's State offers plans that do not include abortion coverage.

<sup>156</sup> Sec. 110 of Graham-Cassidy bill.

<sup>157</sup> Cutler, David M. and Zeckhauser, Richard J., "The Anatomy of Health Insurance," *Handbook of Health Economics*, Chapter 11, 2000, pp. 564-643.

Health insurance is generally desired by individuals who are risk averse, as it provides financial protection against the unexpected cost of negative health events. However, differences in information among buyers and sellers of insurance can lead to sorting (this issue is known as “selection”), which may prevent efficient outcomes in the market.<sup>158</sup> “Death spirals” in health insurance plans are one common example of a selection issue in health insurance. Death spirals occur when healthy individuals choose to be uninsured and only sickly, high-cost individuals remain as potential buyers as prices spiral upwards. If below-average cost individuals opt out of insurance, the average cost of insuring the remaining pool goes up. As insurance prices increase, newly below-average cost individuals may also drop insurance. In such a scenario, a subsidy may help to prevent a death spiral by keeping healthy individuals in the insurance pool.

Selection may also influence the levels of health coverage, as insurers unable to observe the health status of individuals may make coverage offerings that deter high-cost individuals or attract low-cost individuals. This is known as “cream skimming.” In this type of scenario, risk adjustments, such as targeted subsidies, may help. Risk-adjustment payments compensate insurers for the increased cost of insuring high-risk or high-cost individuals, while smaller or perhaps negative payments are made for enrollees with lower costs.

The largest health-related tax expenditure in the United States is the exclusion from an employee’s taxable income of employer contributions for health care, health insurance premiums, and long-term care insurance premiums.<sup>159</sup> The majority of nonelderly persons in the United States receive employer-sponsored health coverage.<sup>160</sup> As providers ideally want to group large pools of individuals so as to generate predictable risk distributions and lower administrative costs, employer-sponsored health coverage is argued to provide a natural pooling mechanism that mitigates certain selection issues if the formation of employer groups is not highly correlated with health status. However, the exclusion for employer-provided health coverage may lead to overconsumption of health care if plans are inefficiently generous, as the exclusion reduces the price of employer-sponsored health care relative to other goods.<sup>161</sup> The exclusion may also distort the labor market by limiting job mobility and changing retirement decisions.<sup>162</sup> This may be a result of “job lock,” where an individual would otherwise make a different job or retirement decision in the absence of a current generous and subsidized employer plan. In addition, some argue that the exclusion is regressive because tax rates, and therefore the

---

<sup>158</sup> Michael Geruso and Timothy J. Layton, “Selection in Health Insurance Markets and Its Policy Remedies,” *Journal of Economic Perspectives*, Vol. 31, No. 4, Fall 2017, pp. 23-50.

<sup>159</sup> Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2018-2022* (JCX-81-18), October 4, 2018.

<sup>160</sup> 2017, Henry J. Kaiser Family Foundation, “Health Insurance Coverage of Nonelderly 0-64,” <https://www.kff.org/other/state-indicator/nonelderly-0-64/>, retrieved on May 24, 2019.

<sup>161</sup> Jonathan Gruber, “The Tax Exclusion for Employer-Sponsored Health Insurance,” *National Tax Journal*, Vol. 64, June 2011, pp. 511-530.

<sup>162</sup> Jonathan Gruber and Brigitte C. Madrian, “Health Insurance, Labor Supply, and Job Mobility: A Critical Review of the Literature,” *Health Policy and the Uninsured*, 2004, pp. 97-178.

benefit of the exclusion, rise with income. On the other hand, if poor health outcomes define consumable wealth, the exclusion helps to properly measure a taxpayer's ability to pay taxes.

Other large health-related tax expenditures include the premium assistance credit, the exclusion of Medicare benefits from income, the deduction for self-employed health insurance, and the deduction for medical expenses above 10 percent of adjusted gross income.<sup>163</sup> These tax expenditures all lower the cost of health insurance or health care expenses. The health proposals in the President's budget generally include replacing the premium assistance credit with block grants to States, repealing Medicaid expansion and converting Medicaid funding to a per capita allotment, repealing the employer shared responsibility penalty for an applicable large employer's failure to provide certain health coverage, numerous modifications to HSAs and high deductible health plans, and other health tax provision changes as described above. Estimates of many of the proposed changes to health tax provisions are grouped together and provided here, but the budget effects of the nontax health proposals are not included.<sup>164</sup>

---

<sup>163</sup> The medical expense deduction under section 213 applies to medical expenses exceeding 10 percent of adjusted gross income of a taxpayer who elects to itemize deductions for 2019. This percent was 7.5 in 2018.

<sup>164</sup> See Congressional Budget Office, *An Analysis of the President's 2020 Budget*, May 2019, for a combined estimate of tax and nontax health provisions.

## PART III – EDUCATION

### A. Establish Education Freedom Scholarships

#### Present Law

##### State tax credit scholarship programs

State tax credit scholarship programs offer a State tax credit to individuals or businesses that make donations to scholarship funds providing financial assistance for students to attend private elementary and secondary schools. The State tax credit generally allows donors to reduce their State taxes owed up to the full amount of the donation depending on the rules of the particular program. State tax credit scholarship programs are one type of private school choice program; other programs include school voucher programs and education savings account programs.

As of January 2018, there were 22 tax credit scholarship programs authorized in 18 States.<sup>165</sup> Such programs awarded scholarships totaling over \$856 million in school year 2016-2017. Most tax credit scholarship programs began in the last 10 years. However, the first such program, in Arizona, awarded scholarships beginning in 1998. The largest such program is the Florida Tax Credit Scholarship Program, which awarded \$641 million in scholarships in the 2017-2018 school year.<sup>166</sup> The average scholarship award in school year 2016-2017 ranged from \$500 to \$5,468 per student, depending on the State.<sup>167</sup>

The features of scholarships offered by State tax credit scholarship programs vary by State and by program. For example, most programs place household income limitations on the student to be eligible for a scholarship, but these income limits vary widely. Other eligibility criteria or scholarship selection factors include disability, prior attendance at or residency in the attendance area of a public school with performance challenges, and grade level. Some scholarship programs require awards to be used for tuition only, while other programs allow the awards to be used for a broader array of education expenses. A few programs allow donors to recommend that their donations fund scholarships for specific students; for example, Arizona

---

<sup>165</sup> Government Accountability Office, *Private School Choice: Requirements for Students and Donors Participating in State Tax Credit Scholarship Programs* (GAO-18-679), September 2018 (hereinafter “GAO Report”).

<sup>166</sup> Florida Tax Credit Scholarship Program Fact Sheet, Florida Department of Education, *available at* <http://www.fldoe.org/core/fileparse.php/5606/urlt/FTC-Sept-2018.pdf> (last visited May 8, 2019). The Florida Tax Credit Scholarship Program tax credit cap amount is designed to increase by 25 percent each year if the annual tax credit amount for the prior fiscal year is equal to or greater than 90 percent of the cap applicable to that fiscal year. Fla. Stat. § 1002.395(5).

<sup>167</sup> GAO Report, *supra*. Average award amounts are based on data from those programs that provided such information.

allows the donor to recommend a specific individual as the scholarship recipient as long as the individual is not the donor's dependent.<sup>168</sup>

The State tax credits offered through these programs vary in amount and design. Some programs are limited to businesses, some are limited to individuals, and some are available to both.<sup>169</sup> Some programs provide credits only against income tax and some programs encompass other types of taxes. More than half of the programs offer tax credits only for cash donations, while the rest allow credits for in-kind donations. The amount of the tax credit varies from 50 percent to 100 percent of the value of the donation, meaning that a 100 percent credit allows the taxpayer to reduce his or her tax liability by one dollar for each dollar donated, up to any maximum donation amount set by the program. Many of the programs allow donors to carry forward unused credits.

States may place limitations on their programs on a per taxpayer basis and overall. Over half of the programs have a maximum tax credit dollar amount per taxpayer ranging from \$150 to \$1 million.<sup>170</sup> Other programs limit the tax credit per taxpayer to a certain percentage of the donor's total income tax liability. Most programs have a maximum total amount of tax credits that may be claimed, ranging from \$1 million to hundreds of millions of dollars, and potential donors must apply to receive a portion of the total. However, three programs in 2018 did not have a program-wide cap.

State departments or agencies and nonprofit organizations share administration of the programs. State tax and education departments generally play a role in administering the tax credits and approving the participating schools or scholarship granting organizations. Nonprofit scholarship granting organizations generally facilitate the donation process and award scholarships to students.

## **Federal tax benefits for elementary and secondary education**

### In general

There is no Federal tax credit under current law for donations to scholarship funds for private elementary and secondary schools.

Prior to August 2018, taxpayers who contributed to State tax credit scholarship programs could claim a Federal tax deduction for the charitable contribution. The resulting Federal tax benefit depended on whether the taxpayer itemized, whether the taxpayer was subject to the alternative minimum tax (AMT), the taxpayer's Federal tax rate, and the amount of the taxpayer's deduction for State and local taxes (which could be reduced by any increase in the

---

<sup>168</sup> Manual for School Tuition Organizations, Arizona Department of Revenue, Office of Economic Research & Analysis, at 12, Aug. 15, 2018, *available at* [https://azdor.gov/sites/default/files/media/REPORTS\\_2018\\_schooltuitionorganizationmanual.pdf](https://azdor.gov/sites/default/files/media/REPORTS_2018_schooltuitionorganizationmanual.pdf).

<sup>169</sup> GAO Report, *supra*.

<sup>170</sup> GAO Report, *supra*.

deduction for the charitable contribution). However, in August 2018, the Treasury Department and the Internal Revenue Service published proposed regulations that, if finalized as proposed, would require that the amount of the taxpayer's charitable contribution deduction be reduced by the amount of any State or local tax credit received or expected to be received in consideration for the taxpayer's contribution, subject to certain exceptions.<sup>171</sup>

Most other Federal tax benefits for education relate to higher education, such as the American Opportunity Tax Credit and the deduction for interest on student loans. However, a few Federal tax benefits subsidize private elementary and secondary education.

#### Gift tax exclusion for educational expenses

Under present law, gift tax is imposed on transfers of property by gift, subject to several exceptions. One exception is the gift tax annual exclusion. Under this exclusion, a donor can transfer up to \$15,000 of property to each of an unlimited number of donees without incurring gift tax on such transfers.<sup>172</sup>

In addition to the gift tax annual exclusion, the Code provides that certain tuition payments are not considered transfers of property by gift for gift tax purposes.<sup>173</sup> This exclusion covers amounts paid on behalf of an individual as tuition to an educational organization described in section 170(b)(1)(A)(ii) (*i.e.*, an institution that normally maintains regular faculty and curriculum and has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on) for the education or training of such individual. No unlimited exclusion is permitted for books, supplies, dormitory fees, board, or other similar expenses that do not constitute direct tuition costs.<sup>174</sup> The exclusion applies only to direct transfers to the educational institution.

These exclusions apply without regard to the relationship of the donor and donee.

#### Section 529 tuition programs and Coverdell education savings accounts

There are two Federal programs that provide tax benefits to savings for elementary and secondary education expenses. A qualified tuition program (often referred to as a "529 plan") is a program established and maintained by a State or agency or instrumentality thereof, or by one or more eligible educational institutions, which satisfies certain requirements and under which a person may purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to the waiver or payment of qualified higher education expenses of the

---

<sup>171</sup> Prop. Treas. Reg. sec. 1.170A-1(h)(3), 83 Fed. Reg. 43563. The proposed regulations are proposed to apply to contributions after August 27, 2018.

<sup>172</sup> Sec. 2503(b). The gift tax annual exclusion is adjusted annually for inflation.

<sup>173</sup> Sec. 2503(e).

<sup>174</sup> Treas. Reg. sec. 25.2503-6(b)(2).

beneficiary (“prepaid tuition contract”).<sup>175</sup> In the case of a program established and maintained by a State or agency or instrumentality thereof, a qualified tuition program also includes a program under which a person may make contributions to an account that is established for the purpose of satisfying the qualified higher education expenses of the designated beneficiary of the account, provided it satisfies certain specified requirements (“tuition savings account”). Under both types of qualified tuition programs, a contributor establishes an account for the benefit of a particular designated beneficiary to provide for that beneficiary’s higher education expenses. Section 529 does not impose a specific dollar limit on the amount of contributions, account balances, or prepaid tuition benefits relating to a qualified tuition account or contract; however, the program is required to have adequate safeguards to prevent contributions in excess of amounts necessary to provide for the beneficiary’s qualified higher education expenses.

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.<sup>176</sup> Annual contributions to Coverdell education savings accounts may not exceed \$2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for taxpayers with modified AGI between \$95,000 and \$110,000 (\$190,000 and \$220,000 for married taxpayers filing a joint return).

Section 529 provides specified income tax and transfer tax rules for the treatment of accounts and contracts established under qualified tuition programs. Section 530 provides similar, but not identical, rules for the treatment of Coverdell education savings accounts.

Contributions to both 529 plans and Coverdell education savings accounts are not tax deductible for Federal income tax purposes, although contributions to 529 plans may be deductible for State income tax purposes. Amounts in the account accumulate on a tax-free basis (*i.e.*, income on accounts in the plan is not subject to current Federal income tax). Distributions from a 529 plan for the purpose of meeting the designated beneficiary’s higher education expenses are generally not subject to tax. In addition, a designated beneficiary may, on an annual basis, receive up to \$10,000 in aggregate 529 plan distributions to be used in connection with expenses for tuition in connection with enrollment or attendance at an elementary or secondary public, private, or religious school. Distributions from a Coverdell education savings account are excluded from the gross income of the distributee (*i.e.*, the student) to the extent that the distribution does not exceed the qualified education expenses, which includes certain elementary and secondary education expenses.

### **Description of Proposal**

The proposal would make available annually \$5 billion of Federal income tax credits to individuals and businesses that make donations to State-authorized nonprofit education

---

<sup>175</sup> Sec. 529.

<sup>176</sup> Sec. 530.

scholarship granting organizations.<sup>177</sup> The Federal tax credit would be a 100-percent credit, and no Federal itemized deduction would be allowed for the same contribution. In addition, no taxpayer would be allowed a total (Federal, state, or local) tax benefit greater than the amount of the taxpayer's contribution.

The scholarship granting organizations will provide Education Freedom Scholarships to eligible families with the donated funds. The scholarships could be used to fund a variety of educational expenses as determined by each State, including private school tuition, career and technical education, apprenticeships, dual-enrollment programs, and programs and services to supplement public school education such as afterschool tutoring programs or special education services. The States will be allowed to set parameters for eligibility requirements for students and education providers and the allowable uses of the funds. States do not have to participate in the program.

Effective date.—The proposal is effective as of January 1, 2020.

### **Analysis**

Proponents may argue that the proposal expands educational opportunities and choice for scholarship recipients by allowing them to pursue elementary and secondary educational options that otherwise may not be available to them. These options may include receiving additional services that are individualized to the student's unique educational needs, which could include private education or services that supplement public education. Proponents may also state that the proposal does not take money away from public schools because the proposal is privately funded and does not divert money from Federal or State education budgets. The proposal is designed to support State-designed and controlled programs rather than create a new Federal program. In addition, providing choice and introducing competition may result in improved educational outcomes for all schools, including public schools.

Proponents also may point to the existing State tax credit scholarship programs, which have been growing in popularity. Proponents may assert that these scholarships have improved educational opportunities for children who otherwise did not have quality educational options.

However, supporters of school choice may agree with the policy goal but take issue with the mechanism for achieving the goal. They may argue that the proposal could invite Federal intervention and encroachment into education policy, which they believe should be made at the State and local level. Federal funding of private schools and other educational programs may allow the Federal government to regulate such schools and programs as a condition of funding. Supporters of school choice may say that the proposal amounts to a large Federal spending program for education, which is not the proper role of the Federal government.

---

<sup>177</sup> The proposal is described in the President's Budget and on a dedicated website of the Department of Education, *available at* <https://sites.ed.gov/freedom/>. The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item III.A.

Opponents may argue that the proposal undermines public education by creating a backdoor mechanism to provide vouchers for private or religious schools. Although private donations fund the scholarship granting organizations, the donation expenditure can be fully offset by a Federal tax credit, such that the Federal government bears the cost of the donation. Opponents may assert that the proposal amounts to the Federal government subsidizing the privatization of education, including religious education, since the Federal tax credit reduces total Federal revenue collected and therefore reduces Federal spending. In addition, even though States may choose to design their programs to supplement public education, in practice many States may not design their programs in that manner and may be only granting money to private and religious education.

Opponents also may argue that the Internal Revenue Code should not be used to implement education policy and encourage donations to certain types of organizations over others. Such opponents may say that direct spending on education would more efficiently achieve the same policy goals. By contrast, pursuing a policy goal via a Federal tax credit creates an additional tax expenditure and adds complexity to the Code without furthering a particular tax policy goal.

The proposal requires that taxpayers are disallowed a tax benefit that exceeds the taxpayer's contribution. However, without proper safeguards, taxpayers may be able to receive more in combined Federal and State tax benefits than they contribute to the scholarship granting organizations. Enforcement may be challenging because it requires the Federal government to have State tax information for relevant taxpayers. States also may not be helpful in providing such information as scholarship granting organizations administering State tax credits have previously advertised to taxpayers that they can profit from making contributions to such organizations.<sup>178</sup> Failure to enforce the limitation on the combined Federal and State tax benefit may provide a money-making opportunity for sophisticated taxpayers.

In addition, if proper safeguards are put in place to effectively implement the limitation on the combined Federal and State tax benefit, then the Federal tax credit may crowd out existing State tax benefits. While States may still maintain programs so that taxpayers can receive Federal benefits, States may no longer have an incentive to provide State level tax benefits since the Federal government is already providing the maximum allowed benefit. Generally, taxpayers should be indifferent between State and Federal tax credits, unless they have no Federal tax liability. The limitation on the total benefit may reduce the effectiveness of the credit as Federal tax credits replace, rather than complement, some existing State tax benefits.

Finally, without proper safeguards, the proposal may allow for self-dealing. For example, donors potentially could receive a Federal tax credit for funding the education of a scholarship recipient with whom they have a personal relationship. Safeguards against self-dealing would need to be well-crafted to allow for proper enforcement.

---

<sup>178</sup> See, e.g., Pay It Forward Scholarships, Donate, *available at* <https://www.payitforward scholarships.com/donate> (last visited May 20, 2019) (“When you donate, you will receive both a Georgia State tax credit AND a federal charitable deduction. You will end with more money than when you started, and you will be helping students receive a good education.”)

**B. Provide Tax Exemption for Indian Health Service (IHS) Health Professions, NURSE Corps, and Native Hawaiian Scholarship and Loan Repayment Programs in Return for Obligatory Service Requirement**

**Present Law**

**Qualified scholarships**

Present law provides an exclusion from gross income for income tax purposes and wages for employment tax purposes for amounts received as a qualified scholarship by an individual who is a candidate for a degree at a qualifying educational organization.<sup>179</sup> In general, a qualified scholarship is any amount received by such an individual as a scholarship or fellowship grant if the amount is used for qualified tuition and related expenses. Qualified tuition and related expenses include tuition and fees required for enrollment or attendance, or fees, books, supplies, and equipment required for courses of instruction, at the qualifying educational organization. This definition does not include regular living expenses, such as room and board. A qualifying educational organization is an educational organization that normally maintains a regular faculty and curriculum and normally has a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on.

The exclusion for qualified scholarships does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship. Instead, amounts received as a qualified scholarship that constitute payments for such services are included in gross income and wages. An exception to this rule applies in the case of the National Health Services Corps Scholarship Program (the “NHSC Scholarship Program”) and the Armed Forces Health Professions Scholarship and Financial Assistance Program (the “Armed Forces Scholarship Program”). Amounts received as a qualified scholarship that represent payment for teaching, research, or other services by the student that are required under these programs is excluded from gross income and wages.

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

**Taxation of student loan forgiveness and repayment**

Gross income generally includes the discharge of indebtedness of the taxpayer. Under an exception to this general rule, gross income does not include any amount from the forgiveness (in whole or in part) of certain student loans, provided that the forgiveness is contingent on the

---

<sup>179</sup> Secs. 117(a) and 3121(a)(20).

student's working for a certain period of time in certain professions for any of a broad class of employers.<sup>180</sup>

Student loans eligible for this special rule must be made to an individual to assist the individual in attending a qualifying educational organization, as defined above. Loan proceeds may be used not only for tuition and required fees, but also to cover room and board expenses. The loan must be made by (1) the United States (or an instrumentality or agency thereof), (2) a State (or any political subdivision thereof), (3) certain tax-exempt public benefit corporations that control a State, county, or municipal hospital and whose employees have been deemed to be public employees under State law, or (4) an educational organization that originally received the funds from which the loan was made from the United States, a State, or a tax-exempt public benefit corporation, if the discharge is not on account of services performed for such educational organization.

In addition, an individual's gross income does not include amounts from the forgiveness of loans made by educational organizations (and certain tax-exempt organizations in the case of refinancing loans) out of private, nongovernmental funds if the proceeds of such loans are used to pay costs of attendance at an educational institution or to refinance any outstanding student loans (not just loans made by educational organizations) provided that the discharge is not on account of services performed for such educational organization. In the case of such loans made or refinanced by educational organizations (or refinancing loans made by certain tax-exempt organizations), cancellation of the student loan must be contingent upon the student working in an occupation or area with unmet needs and such work must be performed for, or under the direction of, a tax-exempt charitable organization or a governmental entity.

An amount paid by a party other than the taxpayer in repayment of the taxpayer's indebtedness is generally included in gross income and, if such amount is remuneration for employment, wages for employment tax purposes. However, an individual's gross income does not include any loan repayment amount received under the National Health Service Corps Loan Repayment Program (the "NHSC Loan Repayment Program"), certain State loan repayment programs, or any amount received by an individual under any State loan repayment or loan forgiveness program that is intended to provide for the increased availability of health care services in underserved or health professional shortage areas (as determined by the State).<sup>181</sup> These amounts are also excluded from wages for employment tax purposes.<sup>182</sup>

The NHSC Loan Repayment Program offers loan repayment to health care professionals who are obligated to provide medical services for a certain number of years at an approved service site identified by the Public Health Service as having a shortage of health care professionals.

---

<sup>180</sup> Sec. 108(f).

<sup>181</sup> Sec. 108(f)(4).

<sup>182</sup> Sec. 3121(a)(20).

## Description of Proposal

The Indian Health Service Health Professions Scholarship Program (the “IHS Health Professions Scholarship Program”) provides financial aid covering tuition, required fees, and other educational living expenses for qualified American Indian and Alaska Native students (members of Federally recognized Tribes only) applying to, accepted by, or enrolled in a health profession program.<sup>183</sup> Students incur an obligation to work in a full-time clinical practice at an Indian Health facility after completion of their course of study upon acceptance of funding from this program. The Indian Health Service Loan Repayment Program (the “IHS Loan Repayment Program”) offers loan repayment to health care professionals who commit to work in Indian health programs providing health care to an underserved population.<sup>184</sup> The IHS Loan Repayment Program awards up to \$40,000 to recipients who agree to serve for a minimum of two years at an Indian health program site. After completing the initial two-year contract, recipients may apply for an extension and continue to serve at the same site or another priority site with one year of loan payment for one additional year of full-time service until qualifying loans are paid.

The Nurse Corps Scholarship Program provides financial aid covering tuition, eligible fees, and other educational living expenses for students accepted by or enrolled in professional nursing degree programs at an accredited school of nursing in the United States. Students are required to work at an eligible facility with a critical shortage of nurses following graduation.<sup>185</sup> The Nurse Corps Loan Repayment Program offers loan repayment to licensed registered nurses and advance practice registered nurses who commit to work full-time in an eligible critical shortage facility in a high need area for at least two years.<sup>186</sup> The Nurse Corps Loan Repayment Program pays 60 percent of unpaid nursing education debt over two years, with an option to extend to an additional year of service for an additional award of 25 percent of the original balance.

The Native Hawaiian Health Scholarship provides scholarships to Native Hawaiians covering tuition, related school costs, and other educational living expenses for students pursuing careers in specified primary and behavioral health disciplines.<sup>187</sup> Students incur an obligation to work in a medically underserved area within the state of Hawaii immediately after graduation or licensure. Students must serve for one year for every year of funding received, with a minimum service requirement of two years and a maximum service requirement of four years.

---

<sup>183</sup> 25 U.S.C. sec. 1613a. The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item III.B.

<sup>184</sup> 25 U.S.C. sec. 1616a.

<sup>185</sup> 42 U.S.C. sec. 297n(d).

<sup>186</sup> 42 U.S.C. sec. 297n(a).

<sup>187</sup> 42 U.S.C. sec. 254s.

The proposal would exempt from income funds received for qualified tuition and related expenses pursuant to the IHS Health Professions Scholarship Program, the Nurse Corps Scholarship Program, and the Native Hawaiian Health Scholarship. The proposal also exempts from income amounts forgiven or repaid under the IHS Loan Repayment Program and the Nurse Corps Loan Repayment Program.<sup>188</sup>

Effective date.—The proposal is effective as of January 1, 2020.

### Analysis

Proponents of the proposal may assert that the proposal lessens the financial burden of obtaining an education for students and health care professionals who are willing to commit to service requirements. The lessened financial burden may provide an incentive for individuals to pursue certain health professions in underserved areas and for underserved groups. Accordingly, the proposal may help ensure that there is a sufficient supply of trained health professionals to provide health care services where there is the greatest need.

Proponents might also argue these programs are similar to programs that are currently subject to exclusion-from-income rules, so treating these programs like the NHSC Scholarship and Loan Repayment Programs and Armed Forces Scholarship Program would be consistent with principles of horizontal equity, *i.e.*, treating similarly-situated taxpayers similarly. The service requirements associated with the IHS Health Professions, Nurse Corps, and Native Hawaiian Health Scholarship Programs are similar to the service requirements associated with the NHSC Scholarship Program and the Armed Forces Scholarship Program. Additionally the requirements for loan repayment of the IHS and Nurse Corps Loan Repayment Programs are similar to the requirements of the NHSC Loan Repayment Program. Furthermore, under present law, participants in the IHS Loan Repayment Program are also eligible to receive payments from the program to reimburse the participant for any tax liability he or she may have incurred as a result of the loan repayment.<sup>189</sup> Excluding amounts for loan forgiveness or repayment from income would allow the program to put these funds for reimbursement to other, program-related uses.

Opponents may argue that the tax system should not be used to incentivize certain professional or educational choices. Opponents might also assert that the scholarship and loan repayment programs that exist under present law provide a sufficient Federal subsidy to underserved areas and underserved populations such that an additional Federal tax incentive is unnecessary to meet the programs' stated goals. In addition, the value of the exemption will vary depending on the taxpayer's personal circumstances such as other income the taxpayer or the

---

<sup>188</sup> The proposal does not address the employment tax treatment of amounts received under the IHS Health Professions, Nurse Corps, and Native Hawaiian Scholarship and Loan Repayment Programs. However, it is our understanding that the proposal would exclude such amounts from wages for employment tax purposes similar to the NHSC Scholarship and Loan Repayment Programs and the Armed Forces Scholarship Program.

<sup>189</sup> 25 U.S.C. sec. 1616a(g)(3).

taxpayer's spouse may earn. Accordingly, a Federal subsidy that provides an exemption as described above cannot be designed to have a uniform benefit. Finally, opponents might argue that the selection of specific professions and employment opportunities for Federal tax incentives is not an appropriate role for the Federal government. This existing horizontal inequity would be further exacerbated by the addition of more Federal programs to the existing exclusion rules.

## PART IV – TAX ADMINISTRATION

### A. Provide Discretionary Funding for IRS Program Integrity Cap Adjustment

#### Present Law

Congress and the Administration may use a budget mechanism known as a program integrity cap adjustment to allow for increases in congressional allocations for annual budget appropriations. Under this mechanism, Congress and the Administration may increase funding above that specified in the annual budget appropriations by increasing the program integrity cap provided the increased spending is for a specific “program integrity” purpose.<sup>190</sup> Broadly, activities which serve “program integrity” are those which increase program effectiveness, including enforcement and compliance initiatives of the IRS.

#### Description of Proposal

The proposal provides a new \$362 million program integrity cap adjustment beginning in 2020 to fund new and continuing investments in expanding and improving the effectiveness and efficiency of the IRS’s tax enforcement program.<sup>191</sup>

Effective date.—The proposal is effective as of the date of enactment.

#### Analysis

One measure of the potential effectiveness of this proposal is to compare the amount of the proposed additional spending on compliance and enforcement initiatives to the projected amount of additional tax revenue generated by subsequent improvements in compliance, if any. The Administration estimates that the additional \$362 million cap adjustment beginning in 2020 will fund initiatives that generate an additional \$3 in revenue for every \$1 in IRS expenses.<sup>192</sup> In analyses of past proposals, the Congressional Budget Office (“CBO”) and the Joint Committee staff have projected the revenue yields per dollar of additional spending to be as high as \$9 of

---

<sup>190</sup> See the Balanced Budget and Emergency Deficit Control Act of 1985, Pub. L. No. 99-177, December 12, 1985, as amended by the Budget Control Act of 2011, Pub. L. No. 112-25, August 2, 2011.

<sup>191</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item IV.A.

<sup>192</sup> Because of budget scorekeeping guidelines used by Congress (as specified by the Balanced Budget Act of 1997, Pub. L. No. 105-33, August 5, 1997), these additional revenues are not counted for budget scorekeeping purposes. However, if a subsequent appropriation (or other) bill provides increased funding for program integrity initiatives, CBO’s estimates of the deficit will incorporate the estimated effects of this provision on revenues.

additional revenue for every \$1 in IRS expenses, and as low as \$1 to \$1, depending on the specifics of the proposal.<sup>193</sup>

The CBO and Joint Committee staff often anticipate the IRS will hire and train new staff as well as modify its computer programs in order to implement expanded and improved compliance programs. As a result, the increase in revenues resulting from additional IRS spending is projected to increase over the first few years as these policies are implemented. The CBO and Joint Committee staff typically expect a gradual decline in later years of similar proposals, reflecting the assumption that the policies with the highest revenue yields would likely be undertaken first. Furthermore, taxpayers would eventually become aware of certain enforcement activities and shift to other forms of tax evasion, leading to a gradual decline in revenue yields.

In addition to direct effects of enforcement activities on revenue collection, increased use of funds through program integrity initiatives may deter noncompliance before it occurs. This deterrent effect is not included in CBO and Joint Committee staff estimates, but may be substantial. Opponents of increasing the IRS program integrity cap argue that increasing enforcement activities such as audits may impose burdens on some compliant taxpayers, for example through monetary and nonmonetary costs of compiling evidence, and meeting with accountants, lawyers, and auditors. Ultimately, however, the impacts of this proposal will depend on the specific individual policies undertaken.

---

<sup>193</sup> Joint Committee on Taxation, *Factors Affecting Revenue Estimates of Tax Compliance Proposals: A Joint Working Paper of the Congressional Budget Office and the Staff of the Joint Committee on Taxation* (JCX-90-16), November 2016. This document can be found on the Joint Committee on Taxation website at [www.jct.gov](http://www.jct.gov).

## **B. Increase Oversight of Paid Tax Return Preparers**

### **Present Law**

#### **Tax return preparers under the Internal Revenue Code**

The Code broadly defines the term “tax return preparer” as any person who prepares for compensation, or who employs other people to prepare for compensation, all or a substantial portion of a tax return or claim for refund.<sup>194</sup> A person is considered a tax return preparer when the person prepares a substantial portion of a return, regardless of whether he or she signs the return.<sup>195</sup> There are no specific educational or professional credentials required to be subject to the rules applicable to tax return preparers.<sup>196</sup> Persons whose duties are merely mechanical or clerical (such as keying in data, typing schedules, printing, or producing copies) are excepted from the definition of tax return preparers, as are IRS officials acting in the course of their official duties and certain volunteers.

#### **Tax return preparers under Circular 230**

Neither the Code nor the related Treasury regulations require paid tax return preparers to meet any qualifications or competency standards before preparing tax returns or claims for refund.<sup>197</sup>

Title 31 of the United States Code authorizes the Secretary to regulate the practice of representatives before the Treasury.<sup>198</sup> Under this authority, the Treasury Department has issued regulations published in Title 31 of the Code of Federal Regulations, and reprinted as Treasury Department Circular No. 230 (“Circular 230”). Circular 230 provides that only attorneys, CPAs, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and certain other specified individuals who meet certain requirements may practice before the IRS.<sup>199</sup> Circular 230 authorizes the Director of the Office of Professional Responsibility to act on applications for enrollment to practice before the IRS, to make inquiries with respect to matters under the

---

<sup>194</sup> Sec. 7701(a)(36)(A); Treas. Reg. sec. 301.7701-15(a).

<sup>195</sup> Treas. Reg. sec. 301.7701-15(b).

<sup>196</sup> Treas. Reg. sec. 301.7701-15(d).

<sup>197</sup> However, these tax return preparers may be subject to State educational or testing (or both) requirements if they practice in States that regulate tax return preparers as do California, Maryland, New York, and Oregon. See IRS Publication 4832, *Return Preparer Review*, December 2009, p. 18.

<sup>198</sup> 31 C.F.R. Part 10 (Rev. 6-2014).

<sup>199</sup> Circular 230 defines practice before the IRS to include all matters connected with a presentation before the IRS (or any of its officers or employees) relating to a taxpayer’s rights, privileges or liabilities under laws or regulations administered by the IRS. This definition includes corresponding and communicating with the IRS, preparing and filing documents, and representing clients at hearings, conferences and meetings. Circular 230, sec. 10.2(a)(4).

Director's jurisdiction, to institute and provide for the conduct of disciplinary proceedings relating to practitioners and appraisers, and to perform such other duties as necessary to carry out those functions.<sup>200</sup>

Prior to 2011, Circular 230 did not apply to an individual tax return preparer unless that person was an attorney, CPA, enrolled agent, enrolled actuary, enrolled retirement plan agent, or other type of practitioner defined in Circular 230. Thus, any individual not listed could prepare tax returns and claims for refund without meeting the qualifications and competency standards provided in Circular 230. In June 2009, the IRS initiated a review of tax return preparers to determine how to ensure consistent standards of conduct for all tax return preparers and to increase taxpayer compliance. During this process, the IRS received input from the public and provided its findings in a report recommending increased oversight of the tax return preparer industry through regulations.<sup>201</sup>

In 2011, the IRS implemented its recommendations by issuing regulations under Circular 230 to regulate all paid tax return preparers.<sup>202</sup> These regulations provide that only attorneys, CPAs, enrolled agents, enrolled actuaries, enrolled retirement plan agents, and a new category, registered tax return preparers, may prepare tax returns for compensation.<sup>203</sup> Moreover, the regulations provide that any individual who is compensated for preparing or assisting with the preparation of all or substantially all of a tax return or refund claim is a practitioner appearing before the IRS, and therefore subject to Circular 230 requirements and to sanction for violating the requirements.<sup>204</sup> The regulations provide that any individual who prepares a tax return for compensation and who is not an attorney, CPA, or enrolled agent must obtain registered tax return preparer status.<sup>205</sup> A registered tax return preparer is any individual who has registered with the IRS and who is not under suspension or disbarment from practice before the IRS.

---

<sup>200</sup> Circular 230, sec. 10.1.

<sup>201</sup> IRS Publication 4832, *Return Preparer Review*, December 2009.

<sup>202</sup> T.D. 9527, Fed. Reg. 32286, Vol. 76, No. 107, June 3, 2011. The regulations include a definition of "tax return preparer" that is consistent with the use of that term in the Code. The regulations also require all preparers to obtain a "preparer tax identification number" ("PTIN") and to use such number on all returns with respect to which the person is considered a tax return preparer. The use of a preparer tax identification number was specifically authorized in section 6109(a)(4), which provides that such number must be included on all returns or claims for refund, when required by regulations prescribed by the Secretary.

<sup>203</sup> Circular 230, sec. 10.8(a). Though these regulations remain, they were found to be invalid by the courts (as discussed below) and therefore were never implemented by the IRS. Rev. Proc. 2014-42, 2014-2 C.B. 192, July 14, 2014 (stating that these regulations are not in effect).

<sup>204</sup> Circular 230, sec. 10.8(a) and (c). In addition, if an individual who is subject to sanction under Circular 230 acts on behalf of an employer, firm, or other entity, that employer, firm, or other entity is subject to sanction if it knew or reasonably should have known of actionable conduct. Circular 230, sec. 10.50(c)(1)(ii).

<sup>205</sup> Any individual who is not an attorney, CPA, enrolled agent, or registered tax return preparer who prepares (or assists in preparing) returns or refund claims or any documents pertaining to any person's tax liability for submission to the IRS (or substantially all of the returns or claims, or a substantial portion of a document) for compensation is subject to Circular 230 rules and sanctions. Accordingly, even though such an individual is not

The regulations require an individual who seeks to be a registered tax return preparer to pass a competency exam or otherwise satisfy standards prescribed by the IRS,<sup>206</sup> to attend continuing education courses,<sup>207</sup> to pass a compliance and suitability check,<sup>208</sup> and to possess a valid preparer tax identification number (“PTIN”) or other such number prescribed by the IRS in forms, instructions, or other guidance.<sup>209</sup>

Since 2011, however, the U.S. District Court for the District of Columbia in *Loving I* (and the U.S. Court of Appeals for the District of Columbia Circuit affirming on appeal in *Loving II*) has enjoined the Secretary of the Treasury from implementing these regulations on the grounds that the Secretary’s authority to regulate practitioners is insufficient to permit regulation of paid tax return preparers whose practice is limited to return preparation.<sup>210</sup> These cases do not affect the requirement separately found under the Code and the regulations thereunder that preparers possess a valid PTIN.<sup>211</sup>

### **Court cases related to application of Circular 230 to tax return preparers**

In *Loving I*, the U.S. District Court for the District of Columbia was asked to determine if under the Supreme Court’s two-step analysis in *Chevron U.S.A, Inc. v. Natural Res. Def. Council Inc.*<sup>212</sup> the Department of the Treasury exceeded its statutory authority under Title 31 of the U.S.

---

authorized to prepare returns for compensation, he or she becomes subject to Circular 230 rules by reason of preparing returns for compensation. Circular 230, sec. 10.8(a), (c). The IRS has determined that individuals who are not attorneys, CPAs or enrolled agents may prepare and sign for compensation tax returns other than a Form 1040, U.S. Individual Income Tax Return, without having to pass a competency exam or take continuing education. See Notice 2011-6, 2011-3 I.R.B. 315. These individuals may obtain a PTIN, sign the returns they prepare, and may represent the taxpayer before the IRS with respect to a return they signed. They may not represent themselves to the public or to the IRS as a registered tax return preparer or a Circular 230 practitioner, but by preparing a tax return they become subject to the rules and sanctions in Circular 230.

<sup>206</sup> See Notice 2011-6, 2011-3 I.R.B. 315, December 30, 2010; Circular 230, sec. 10.4(c).

<sup>207</sup> See Circular 230, sec. 10.6(f).

<sup>208</sup> See Circular 230, sec. 10.5(d). See also Circular 23, secs. 10.6 and 10.9 (requiring registered tax return preparers, enrolled agents, and enrolled retirement plan agents to take continuing education to satisfy renewal requirements).

<sup>209</sup> Circular 230, sec. 10.4(c).

<sup>210</sup> *Loving v. I.R.S.*, 917 F.Supp.2d 67 (D.D.C. 2013), (“*Loving I*”), modified by *Loving v. I.R.S.*, 742 F.3d 1013 (D.C. Cir. 2014), (“*Loving II*”).

<sup>211</sup> Following *Loving I* and *Loving II*, preparers who were previously required to seek registered tax return preparer status are still required to obtain a PTIN under the authority of section 6109 of the Code and can prepare returns and appear before the IRS in connection with returns they have prepared. See Notice 2011-6, 2011-3 I.R.B. 315.

<sup>212</sup> The Supreme Court stated that “. . . legislative regulations are given controlling weight unless they are arbitrary, capricious, or manifestly contrary to the statute.” 467 U.S. 837, 844 (1984).

Code.<sup>213</sup> The Court held that the general authority of the Secretary to regulate conduct before the Department of the Treasury did not include tax return preparation within its scope.<sup>214</sup> The Court entered a preliminary injunction against enforcement of Circular 230 with respect to paid tax return preparers unless the paid tax return preparer is representing the taxpayer during an examination.

In *Loving II*, the U.S. Court of Appeals for the D.C. Circuit affirmed the judgment of the District Court after reviewing the decision *de novo*. The court rejected the IRS's argument that a paid tax return preparer is a "representative," citing the paid tax return preparer's lack of authority to legally bind the taxpayer. Additionally, the court rejected the IRS's argument that the meaning of "presenting a case" is irrelevant as the scope of the statute is not so limited. The court ruled that the statute's grant of authority to regulate those that "practice ... before the Department of the Treasury" could not be construed to encompass the preparing and signing of tax returns because "practice" only includes traditional adversarial proceedings.<sup>215</sup>

As a result of *Loving I* and *Loving II*, the IRS is enjoined from requiring attendance or collecting fees with respect to the testing and education programs of return preparers and from imposing penalties for failure to participate. Additionally, the plaintiffs in *Loving I* and *II* did not object to the IRS further regulating paid tax return preparers that represent taxpayers during an examination, and the court explicitly permitted the IRS to regulate such paid tax return preparers.

In another case, *Brannen v. United States*, the Court of Appeals for the 11<sup>th</sup> Circuit determined the IRS's PTIN program along with the required user fee to be lawful.<sup>216</sup> Conversely, in a later case, *Adam Steele, et. al. v. United States*, the U.S. District Court for the District of Columbia held that the IRS had no authority to impose user fees to obtain a PTIN.<sup>217</sup> In so holding, the court determined that allowing the imposition of user fees would be equivalent to imposing a regulatory licensing scheme and the IRS did not have such authority. The ruling

---

<sup>213</sup> The first step of the *Chevron* analysis is to ask whether the intent of Congress is clear or ambiguous. If the intent of Congress is ambiguous, the reviewing court proceeds to the second step. The second step is to ask whether the agency's interpretation is a reasonable interpretation of the statute. *Loving I*, p. 8.

<sup>214</sup> *Loving I*.

<sup>215</sup> *Loving II*, p. 12. Using similar reasoning, a district court permanently enjoined the IRS from enforcing the ban in Circular 230 on the use of contingent fee arrangements to compensate preparation of refund claims. Although the plaintiff was a certified public accountant who could be subject to the regulations of Circular 230 generally, the Court held that preparation of refund claims did not constitute practice before Treasury, and thus fees for such services were not subject to regulation by Treasury. *Ridgely v. Lew*, 55 F. Supp. 3d 89 (D.D.C. 2014).

<sup>216</sup> 682 F. 3d 1316 (11th Cir. 2012) (holding that the regulation imposing a user fee to obtain a PTIN was correctly established in accordance with section 9701); *Buckley v. United States*, (D.C. Ga. Dec. 4, 2013), 112 AFTR 2d 2013-7255. The District Court in *Buckley* came to a similar conclusion and upheld the IRS's authority to impose a fee on practitioners seeking a PTIN. It also found *Loving* — which at the time was a district court decision — inapplicable because it dealt with the IRS's authority to require competency testing and continuing education requirements for return preparers, which were not at issue in *Buckley*.

<sup>217</sup> The case was a class action representing all individuals and entities who have paid a PTIN. 260 F. Supp. 3d 52 (June 1, 2017).

also required the IRS to refund PTIN fees already paid by preparers. However, the D.C. Circuit subsequently vacated the lower court's decision and held that the IRS has the authority to charge a fee for issuing or reviewing preparer tax identification numbers.<sup>218</sup> In so holding, the court determined that the fee was justified because a PTIN confers a specific benefit to tax return preparers by helping protect the confidentiality of their Social Security number.<sup>219</sup> The court further determined that the issue of whether the amount of the fee was reasonable could be decided by the lower court on remand.<sup>220</sup>

### **IRS's voluntary approach**

The IRS publishes on its website a directory of tax return preparers with PTINs that includes a list of attorneys, CPAs, enrolled agents, enrolled actuaries, and enrolled retirement plan agents, as well as practitioners who have received a "record of completion."<sup>221</sup> Practitioners can receive a record of completion if they: (i) take an annual federal tax filing season refresher course that is administered by an IRS-approved continuing education provider; (ii) pass a test on the material presented during the course; and (iii) complete 18 hours of continuing education from IRS-approved providers.<sup>222</sup> To obtain the record of completion, the practitioner also has to agree to be subject to duties and restrictions relating to practice before the IRS imposed under subpart B and section 10.51 of Circular 230. A practitioner who is not an attorney, a CPA, an enrolled agent, or an enrolled actuary and who does not have a record of completion will not be permitted to represent a taxpayer before the IRS in connection with an examination of a return even though the practitioner prepared and signed the return.

---

<sup>218</sup> *Montrois v. United States*, 916 F.3d 1056 (D.C. Cir. 2019).

<sup>219</sup> *Ibid.*, p. 1064.

<sup>220</sup> *Ibid.*, p. 1066.

<sup>221</sup> Available at <https://irs.treasury.gov/rpo/rpo.jsf>, last accessed on May 6, 2019 (according to the website, this directory is updated regularly and is current as of 04/30/2019).

<sup>222</sup> Rev. Proc. 2014-42, 2014-2 C.B. 192. The AICPA raised concerns with the voluntary program in a letter to the IRS, available at <https://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/AICPA-Letter-to-Comm-Koskinen-June-24-2014.pdf>. The AICPA sued to enjoin the Annual Filing Season Program and the U.S. District Court for the District of Columbia has held on two occasions that the AICPA lacked standing, most recently in August 2016. *AICPA vs. IRS*, 199 F. Supp. 3d 55 (D.D.C. 2016). The case was appealed to the U.S. Court of Appeals for the D.C. Circuit which held that while the AICPA had standing to challenge the program, Treasury has the authority to regulate the people who practice before it, and the program did not violate the Administrative Procedure Act. *AICPA vs. IRS*, 746 Fed.Appx. 1 (D.C. Cir. 2018).

## Description of Proposal

The proposal gives the Secretary of the Treasury the authority to regulate all paid tax return preparers.<sup>223</sup>

Effective date.—The proposal is effective on the date of enactment.

## Analysis

Tax assessment and collection in the United States depends on the voluntary compliance of taxpayers. To assist with their filing and payment obligations, more than half of all taxpayers seek the advice of paid tax return preparers to prepare and file their tax returns. For the tax years from 2000 to 2016, the percentage of returns completed by paid preparers has fluctuated between a low of 53 percent, in 2000 and 2016, and a high of 60 percent, in 2005. Over this period, the number of returns filed has increased from 129 million to 150 million, and the number of returns completed by a paid preparer has increased from 69 million to 80 million, though the latter number peaked in tax year 2007 at 84 million.<sup>224</sup> Thus, the competence and professionalism of tax return preparers has a meaningful impact on taxpayer compliance.

In past years, several groups charged with oversight, including the Government Accountability Office (“GAO”) and the Treasury Inspector General for Tax Administration (“TIGTA”) have identified errors and noncompliance related to the earned income credit on returns prepared by unlicensed paid practitioners.<sup>225</sup> For its study, the GAO noted that its findings were consistent with its earlier analysis of IRS’s National Research Program (“NRP”) database from tax years 2006 through 2009 which showed that tax returns prepared by preparers

---

<sup>223</sup> The proposal does not specify whether any enacting legislation would amend the Code or Title 31. The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item IV.B.

<sup>224</sup> For the total number of returns, see Internal Revenue Service, *Statistics of Income—2016 Individual Income Tax Returns Complete Report, Publication 1304, Table A. All Returns: Selected Income and Tax Items in Current and Constant 1990 Dollars, Tax Years 1990-2016*, September 2018, available at <https://www.irs.gov/statistics/soi-tax-stats-individual-income-tax-returns-publication-1304-complete-report>. For the number of returns with paid preparer signatures, see Internal Revenue Service, *Statistics of Income—Individual Income Tax Returns, Table 22, Number of Taxpayers Using Paid Preparers, Tax Years 2000-2016*, available at <http://www.irs.gov/uac/SOI-Tax-Stats-Historical-Table-22>. As the latter number only includes tax returns that are signed by paid tax return preparers, it likely underestimates the number of Americans utilizing paid tax return preparers because many tax return preparers fail to sign tax returns, notwithstanding the penalty provided in section 6695(b).

<sup>225</sup> GAO and TIGTA have completed studies that analyzed the accuracy of returns prepared by unenrolled agents. In a study by GAO, two of the 19 tax returns prepared for the GAO showed the correct refund amount. Government Accountability Office, *In a Limited Study, Preparers Made Significant Errors* (GAO-14-467T), April 2014. In a study by TIGTA, 11 of the 28 tax returns prepared for TIGTA showed the correct refund amount. Inspector General for Tax Administration, Department of the Treasury, *Most Tax Returns Prepared by a Limited Sample of Unenrolled Preparers Contained Significant Errors* (TIGTA 2008-40-171), September 2008. GAO conducted an earlier study in 2006 that yielded similar results. Government Accountability Office, *Paid Tax Return Preparers: In a Limited Study, Chain Preparers Made Serious Errors* (GAO-06-563T), April 4, 2006.

had a higher estimated percent of errors—60 percent—than self-prepared returns—50 percent.<sup>226</sup> An IRS research paper using the NRP estimated that for returns claiming the EIC, unlicensed preparers had the highest error rates and over-claim percentages of all preparer types,<sup>227</sup> which is consistent with previous estimates by the National Taxpayer Advocate.<sup>228</sup>

Those who support new regulation of paid tax return preparers by the Treasury and IRS argue that errors by tax return preparers can be minimized by maintaining appropriate standards of practice.<sup>229</sup> They argue that under present law anyone is permitted to prepare a return for compensation, regardless of competence or adherence to ethical or professional standards. In addition, the oversight of tax return preparers as a group differs based on a number of distinctions, such as whether the preparer is enrolled or unenrolled to practice before the IRS, whether the preparer is a CPA or an attorney, whether the preparer chooses to file electronically, and the jurisdiction in which the preparer practices.<sup>230</sup>

Supporters of regulation of paid tax return preparers point to requirements established in four States as possible models for Federal regulation. In the State of Oregon, paid preparers that are not exempt (*i.e.*, attorneys, CPAs, etc.) are required to complete qualifying education courses, pass a state-administered examination, and register to be certified as a licensed tax preparer. In addition, preparers must complete 30 hours of continuing education and re-register in each subsequent year. In the State of California paid preparers that are not exempt are required to complete qualifying education courses and register to be certified as a licensed tax preparer. In

---

<sup>226</sup> In addition, in a 2002 report, the GAO found that as many as 1.1 million taxpayers who used the services of a paid preparer are likely to have overpaid their taxes because they took the standard deduction instead of itemizing deductions. Government Accountability Office, *Tax Deductions: Further Estimates of Taxpayers Who May Have Overpaid Federal Taxes by Not Itemizing* (GAO-02-509), March 29, 2002.

<sup>227</sup> Kara Leibel, Internal Revenue Service, Publication 5161, *Taxpayer Compliance and Sources of Error for the Earned Income Tax Credit Claimed on 2006-2008 Returns*, August 2014, p. 41.

<sup>228</sup> National Taxpayer Advocate, *2002 Annual Report to Congress*, pp. 216-230.

<sup>229</sup> IRS Publication 4832, *Return Preparer Review*, December 2009, p. 18; Senate Committee on Finance Report to Accompany S.1321, the “Telephone Excise Tax Repeal and Taxpayer Protection and Assistance Act of 2006,” S. Rept. No. 109-336, September 15, 2006, p. 8 (“the Committee believes that the IRS’s failure to provide more oversight over such tax return preparers contributes to noncompliance. The Committee also believes that tax return preparer regulation will improve the accuracy of tax return preparation and, therefore, will reduce government burden and intrusion on taxpayers through IRS enforcement efforts (such as collection and examinations”).

<sup>230</sup> National Taxpayer Advocate, *2018 Annual Report to Congress*, pp. 105-116; National Taxpayer Advocate, *2013 Annual Report to Congress*, pp. 61-74; National Taxpayer Advocate, *2009 Annual Report to In Congress*, pp. 41-69; National Taxpayer Advocate, *2008 Annual Report to Congress*, p. 503-512; National Taxpayer Advocate, *2006 Annual Report to Congress*, pp. 197-221; National Taxpayer Advocate, *2005 Annual Report to Congress*, pp. 223-237; National Taxpayer Advocate, *2004 Annual Report to Congress*, pp. 67-88; National Taxpayer Advocate, *2003 Annual Report to Congress*, pp. 270-301; National Taxpayer Advocate, *2002 Annual Report to Congress*, pp. 216-230; *Fraud in Income Tax Return Preparation: Hearing Before the Subcommittee on Oversight of the H. Comm. on Ways and Means, 109th Cong. (2005)* (statement of Nina E. Olson, National Taxpayer Advocate).

addition, preparers must complete 20 hours of continuing education annually.<sup>231</sup> The GAO noted that Oregon’s regulations may have led to more accurate Federal tax returns in that State but that California’s regulations may not have had that effect.<sup>232</sup> In the State of Maryland, paid preparers who are not exempt are required to register to be certified as a licensed tax preparer by passing a state-administered examination. In addition, preparers must complete eight hours of continuing education annually and re-register every two years.<sup>233</sup> In the State of New York individuals who prepare a substantial portion of any return for compensation who are not exempt must register to be certified as a licensed tax preparer and must re-register annually.<sup>234</sup> Paid preparers are not subject to qualifying education, continuing education or testing requirements.<sup>235</sup>

Supporters of the proposal further point to the GAO’s study that current oversight of paid tax return preparers is challenging.<sup>236</sup> For example, the IRS named return preparer fraud as one of its Dirty Dozen Tax Scams,<sup>237</sup> and investigated paid tax preparers’ criminal activity and referred such criminal activity to the Department of Justice.<sup>238</sup> Due to resource limitations,

---

<sup>231</sup> IRS Publication 4832, *Return Preparer Review*, December 2009, p. 20.

<sup>232</sup> Government Accountability Office, *Tax Preparers: Oregon’s Regulatory Regime May Lead to Improved Federal Tax Return Accuracy and Provides a Possible Model for National Regulation* (GAO-08-781), August 15, 2008.

<sup>233</sup> IRS Publication 4832, *Return Preparer Review*, December 2009, pp. 20-21.

<sup>234</sup> *Ibid.*, pp. 21-22.

<sup>235</sup> *Ibid.*, pp. 21-22; Government Accountability Office, *In a Limited Study, Preparers Made Significant Errors* (GAO-14-467T), p. 7, April 2014.

<sup>236</sup> Government Accountability Office, *Tax Administration, Most Taxpayers Believe They Benefit from Paid Tax Preparers, but Oversight for IRS is a Challenge* (GAO-04-70), October 2003.

<sup>237</sup> Internal Revenue Service, *IRS Concludes “Dirty Dozen” List of Tax Scams for 2019: Agency Encourages Taxpayers to Remain Vigilant Year-Round*, IR-2019-49, March 20, 2019, available at <https://www.irs.gov/newsroom/irs-concludes-dirty-dozen-list-of-tax-scams-for-2019-agency-encourages-taxpayers-to-remain-vigilant-year-round>; Internal Revenue Service, *IRS: Choose Tax Preparers Carefully; Tax Return Preparer Fraud Makes IRS’ 2019 “Dirty Dozen” List of Tax Scams*, IR-2019-32, March 7, 2019, available at <https://www.irs.gov/newsroom/irs-choose-tax-preparers-carefully-tax-return-preparer-fraud-makes-irs-2019-dirty-dozen-list-of-tax-scams>; see also Department of Justice, *Justice Department Continues Nationwide Enforcement Actions Against Dishonest Tax Return Preparers*, April 2019, available at <https://www.justice.gov/opa/pr/justice-department-continues-nationwide-enforcement-actions-against-dishonest-tax-return>.

<sup>238</sup> Internal Revenue Service, *Ten Things for Taxpayers to Think About When Choosing a Tax Preparer*, IRS Tax Tip 2019-06, February 7, 2019, available at <https://www.irs.gov/newsroom/ten-things-for-taxpayers-to-think-about-when-choosing-a-tax-preparer>.

however, the IRS Criminal Investigation Division is currently able to identify and investigate only the most egregious cases of paid return preparer fraud.<sup>239</sup>

On the other hand, opponents of regulation question whether the regulatory burden placed on return preparers outweighs the potential benefits of such regulations.<sup>240</sup> They express concern that some paid tax return preparers will be forced to either raise their prices or close their businesses due to the burden of complying with regulations, and that these effects will be most keenly felt by tax return preparers serving low-income clients.<sup>241</sup> They argue that the real beneficiaries of any regulation are those who generate profit from preparing returns such as large, established companies. They argue that some small businesses may be unable to bear the costs of complying with the rules and as a result may close. As a result, opponents argue that regulating preparers will increase the costs for tax preparation for middle and low-income taxpayers as only costlier choices will survive.

---

<sup>239</sup> For example, in fiscal year 2018, the IRS Criminal Investigation Division only initiated 224 investigations. Internal Revenue Service, *Statistical Data – Abusive Return Preparers*, available at [https://www.irs.gov/pub/irs-utl/2018\\_irs\\_criminal\\_investigation\\_annual\\_report.pdf](https://www.irs.gov/pub/irs-utl/2018_irs_criminal_investigation_annual_report.pdf).

<sup>240</sup> American Institute of Certified Public Accountants (“AICPA”), Letter to Chairman Hatch and Ranking Member Wyden, “Chairman’s Mark of a Bill to Prevent Identity Theft and Tax Refund Fraud,” September 15, 2015, pp. 5-6, available at <http://www.aicpa.org/Advocacy/Tax/DownloadableDocuments/2015-09-15-Prevent-ID-Theft-and-Tax-Refund-Fraud-Comment-Letter-FINAL.pdf> (AICPA expressed that it has concerns about granting the IRS unlimited authority to regulate tax return preparers and requested that the IRS’s authority to issue PTINs be limited and that unenrolled PTIN holders who use advertising explain the qualifications of different tax preparers and explain that the IRS does not endorse any particular return preparer); “Regulation of Tax Return Preparers,” 2011, p. 12, available at [https://www.aicpa.org/InterestAreas/Tax/Resources/IRSPracticeProcedure/DownloadableDocuments/PTIN\\_article\\_final.pdf](https://www.aicpa.org/InterestAreas/Tax/Resources/IRSPracticeProcedure/DownloadableDocuments/PTIN_article_final.pdf) (AICPA questions whether the cost will result in raising the competency and professional standards of unlicensed preparers).

<sup>241</sup> In *Loving*, one of the plaintiffs argued that she would have to increase prices and would likely lose customers. The other two plaintiffs asserted that they would likely be forced to stop preparing tax returns. *Loving v. IRS*, 917 F. Supp.2d 67 (D.D.C. 2013), (“Loving I”), modified by *Loving v. IRS*, 742 F.3d 1013 (D.C. Cir. 2014), (“Loving II”).

## **C. Provide More Flexible Authority for the Internal Revenue Service to Address Correctable Errors**

### **Present Law**

The Federal income tax system relies upon self-reporting and assessment. A taxpayer is expected to prepare a report of his liability<sup>242</sup> and submit it to the IRS with any payment due. The Code provides general authority for the IRS to assess all taxes shown on returns<sup>243</sup> other than certain Federal unemployment tax and estimated income taxes.<sup>244</sup> The assessment is required to be made by recording the liability in the “office of the Secretary” in a manner determined under regulations.<sup>245</sup> If the IRS determines that the assessment was materially incorrect, additional tax may only be assessed within the applicable limitations period.<sup>246</sup>

The authority to assess additional tax may be subject to certain restrictions on assessment known as the deficiency procedures.<sup>247</sup> A deficiency of tax occurs if the amount of certain taxes<sup>248</sup> self-assessed for a period, after reduction for any rebates of tax, is less than the liability determined under the Code. If the IRS questions whether the correct tax liability has been assessed by a taxpayer, the IRS generally first informs the taxpayer by letter. Most discrepancies in liability identified by the IRS are resolved through such “correspondence audits.” In the case of a correspondence audit, if the taxpayer does not comply after receipt of the initial letter, an examining agent reviews the return and any additional information provided by the taxpayer and determines whether an adjustment in tax is required. The determination by the examining agent that an adjustment to the return is required results in a notice to the taxpayer that provides an opportunity for the taxpayer to invoke rights to an administrative appeal or to agree to the adjustments within 30 days. If the taxpayer disputes the adjustments and invokes appeal rights, the case is referred to an independent administrative appeals officer for review. In most administrative appeals, the taxpayer and the IRS agree on the merit or lack of merit of the adjustments proposed. If the parties do not reach agreement administratively or the taxpayer does not invoke administrative appeal rights, the IRS must issue a formal notice of deficiency to a taxpayer,<sup>249</sup> which begins a period within which a taxpayer may petition the U.S. Tax Court for review of the taxpayer’s case. During that period, as well as during the pendency of any

---

<sup>242</sup> Sec. 6011 and 6012.

<sup>243</sup> See section 6201(a), which authorizes assessment of tax computed by the taxpayer as well as amounts computed by the IRS at the election of the taxpayer, under section 6014.

<sup>244</sup> Sec. 6201(b).

<sup>245</sup> Sec. 6203.

<sup>246</sup> Sec. 6204.

<sup>247</sup> Secs. 6211 through 6215.

<sup>248</sup> The taxes to which deficiency procedures apply are income, estate and gift, and excise taxes arising under chapters 41, 42, or 44. Secs. 6211 and 6213.

<sup>249</sup> Sec. 6212.

proceeding in Tax Court, assessment of the deficiency is not permitted but interest may be incurred on any liability ultimately determined.<sup>250</sup>

There are several exceptions to the restrictions on assessment of taxes that are generally subject to the deficiency procedures.<sup>251</sup> One of the principal exceptions is the authority to make a summary assessment of tax without issuance of a notice of deficiency if the tax is a result of a mathematical or clerical error, generally referred to as math error authority. Purely mathematical or clerical issues are often identified early in the processing of a return, prior to issuance of any refund; they are not typically uncovered as a result of a deficiency procedure examination of a return.

If the mistake on the return is of a type that is within the meaning of mathematical or clerical error, the IRS assesses the additional tax due as a result of correcting the mistake and sends notice of the math error to the taxpayer. The issuance of a notice of math error begins a 60-day period within which a taxpayer may submit a request for abatement of the math error adjustment, which then requires the IRS to abate the assessment and refer the unresolved issue for examination under the deficiency procedures.

This exception to the restriction on assessment originally was limited to mathematical errors, but was expanded to include clerical or transcription errors, and then was further expanded to address various specific cases.<sup>252</sup> Many issues covered by the math error authority relate to rules regarding refundable credits.<sup>253</sup> Math error authority is used to deny a claimed credit, either during the initial processing of a return on which the credit is claimed or in an examination of the return after the refund has been issued, and immediately assess any additional tax due without issuing a notice of deficiency. For example, in 2015, math error authority was expanded to cover situations in which: (1) a taxpayer claimed the earned income credit, child tax credit, or the American opportunity tax credit (“AOTC”) during the period in which a taxpayer is not permitted to claim such credit as a consequence of having made a prior fraudulent or reckless claim; and (2) there was an omission of information required by the Secretary relating to a taxpayer making improper prior claims of the child tax credit or the AOTC.<sup>254</sup>

---

<sup>250</sup> Sec. 6213(a). If a taxpayer wishes to contest the merits in a different court, the taxpayer may agree to assessment of the tax, reserving his or her rights to contest the merits, pay the disputed amount, and pursue a claim for refund reviewable in a suit in Federal district court or Court of Federal Claims.

<sup>251</sup> Section 6213 provides that a taxpayer may waive the restrictions on assessment, permits immediate assessment to reflect payments of tax remitted to the IRS and to correct amounts credited or applied as a result of claims for carrybacks under section 1341(b), and requires assessment of amounts ordered as criminal restitution. Assessment is also permitted in certain circumstances in which collection of the tax would be in jeopardy. Sections 6851, 6852 or 6861.

<sup>252</sup> Secs. 6213(g)(2)(A) through (Q).

<sup>253</sup> Math error authority currently applies to certain errors related to the earned income credit, the child tax credit, and the American opportunity tax credit.

<sup>254</sup> Secs. 6213(g)(2)(K), (P), and (Q). Protecting Americans From Tax Hikes Act of 2015 (“PATH Act”), Pub. L. No. 114-113, Div. Q, sec. 208.

## Description of Proposal

The proposal expands IRS authority to assess tax, notwithstanding the restrictions on assessments, to include cases where: (1) the information provided by the taxpayer does not match the information contained in government databases, Form W-2, *Wage and Tax Statement*, or from other third party databases as the Secretary determines by regulations; (2) the taxpayer has exceeded the lifetime limit for claiming a deduction or credit; or (3) the taxpayer has failed to include with his or her return certain documentation that is required to be included on or attached to the return.<sup>255</sup>

Effective date.—The proposal is effective for taxable years beginning after December 31, 2019.

## Analysis

The proposal presents the issue of how to balance the need for efficient allocation of government resources with the need for adequate taxpayer safeguards. Under current law, the IRS has the authority to correct math or clerical errors, *i.e.*, arithmetic mistakes, on a return using summary assessment procedures. When it makes such a summary assessment, taxpayers cannot obtain judicial review before satisfying the proposed tax liability unless they respond to an IRS math error notice requesting an abatement.<sup>256</sup>

The efficiency argument reasons that by avoiding time-consuming examination and possible judicial review of issues that are readily identified mistakes (*e.g.*, transposition of numbers, addition errors) that a taxpayer cannot reasonably challenge, the IRS conserves its resources. For example, the proposal also allows for timely use of the authority by the Treasury, when an issue is identified, without waiting for a legislative change to grant the IRS the authority on a case by case basis. At the same time, the proposal arguably threatens taxpayer safeguards in that the expansion of the summary assessment authority in two of the three cases specified – discrepancies between returns and government databases and failure to provide statutorily required documentation – is potentially overbroad and may lead to assessment of tax in cases where tax is not due for multiple reasons.

First, it is not clear that all information obtained by government and third party databases and by Form W-2 is sufficiently reliable to warrant a conclusion that a mismatch between these sources and information on a tax return should result in an immediate deficiency assessment. Moreover, the premise that a discrepancy between information in a government database obtained by a third party information return and a tax return is adequate grounds on which to permit a summary assessment is contrary to the Code that suggests that the mere inclusion of

---

<sup>255</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item IV.C.

<sup>256</sup> Sec. 6213(b)(2).

information on a third party information return is insufficient to support a potential adjustment to a return.<sup>257</sup>

The expanded scope of math error assessment authority and the manner in which it is used by the IRS has generated discussion among oversight agencies. The National Taxpayer Advocate identifies improper use of math error authority as one of the most serious problems in tax administration<sup>258</sup> and proposes legislative restrictions on its use.<sup>259</sup> The National Taxpayer Advocate also notes that the current IRS math error notices do not provide a clear explanation of the alleged error, such that it is difficult for taxpayers to determine what the IRS is proposing to change.<sup>260</sup> By contrast, the Government Accountability Office focuses on the need to avoid erroneous issuance of refunds and proposes that math error authority be expanded to permit better administration of refundable credits.<sup>261</sup>

---

<sup>257</sup> See section 6201(d), which requires reasonable verification of information returns in any court proceeding if a taxpayer asserts a reasonable dispute with respect to any item of income on an information return.

<sup>258</sup> National Taxpayer Advocate, *2018 Annual Report to Congress*, vol. 1, pp. 174-196 (Most Serious Problem No. 12: Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden); National Taxpayer Advocate, *2014 Annual Report to Congress*, vol. 1, pp. 163-171 (Most Serious Problem No. 16: The IRS Does Not Clearly Explain Math Error Adjustments, Making It Difficult for Taxpayers to Understand and Exercise Their Rights); National Taxpayer Advocate, *2011 Annual Report to Congress*, vol. 1, pp. 74-92 (Most Serious Problem No. 4: Expansion of Math Error Authority and Lack of Notice Clarity Create Unnecessary Burden and Jeopardize Taxpayer Rights).

<sup>259</sup> National Taxpayer Advocate, *2015 Annual Report to Congress*, pp. 329-339 (Legislative Recommendation No. 2: Authorize the IRS to Summarily Assess Math and “Correctable” Errors Only in Appropriate Circumstances) (arguing that Congress should consider expanding math error only in one of the situations described in the Administration’s proposal which is where there is no doubt that the taxpayer has claimed amounts in excess of a lifetime limitation based on information shown on the return as could be the case with the American opportunity tax credit); National Taxpayer Advocate, *2011 Annual Report to Congress*, vol. 1, pp. 524-530 (Legislative Recommendation No. 3: Mandate that the IRS, In Conjunction with the National Taxpayer Advocate, Review Proposed Expanded Math Error Authority to Protect Taxpayer Rights).

<sup>260</sup> National Taxpayer Advocate, *2018 Annual Report to Congress*, vol. 2, pp. 194-210 (Literature Review: Improving Notices Using Psychological, Cognitive, and Behavioral Science Insights) (review how notices can be improved using insights from the available psychological, cognitive, and behavioral science research); Statement of Nina E. Olson, National Taxpayer Advocate, Oversight Subcommittee of the House Committee on Ways and Means, “IRS Reform: Perspectives from the National Taxpayer Advocate,” May 19, 2017, available at [https://www.irs.gov/pub/tas/nta\\_written\\_testimony\\_irs\\_reform\\_nta\\_perspectives\\_5\\_19\\_2017.pdf](https://www.irs.gov/pub/tas/nta_written_testimony_irs_reform_nta_perspectives_5_19_2017.pdf).

<sup>261</sup> Government Accountability Office, *IRS Dealt with Challenges to Date, but Needs Additional Authority to Verify Compliance* (GAO 11-481), March 2011. In testimony before the Oversight Subcommittee of the House Committee on Ways and Means, GAO recommended that the IRS be provided math error authority to use prior years’ tax return information to ensure that taxpayers do not improperly claim credits or deduction in excess of applicable lifetime limits. Statement of Michael Brostek, Director Strategic Issues, Government Accountability Office, Oversight Subcommittee of the House Committee on Ways and Means, “Enhanced Prerefund Compliance Checks Could Yield Significant Benefits,” (GAO-11-691T), May 25, 2011, available at [https://waysandmeans.house.gov/UploadedFiles/Brostek\\_Testimony.pdf](https://waysandmeans.house.gov/UploadedFiles/Brostek_Testimony.pdf).

The National Taxpayer Advocate proposes four factors be weighed before an issue is added to the list for which math error authority is permitted: (i) the issue is not factually complex; (ii) the adjustment can be determinable by reference to a reliable government database; (iii) no analysis of facts and circumstances is required; and (iv) there is not an historically high abatement rate with respect to the issue.<sup>262</sup> Arguably, the first three factors proposed by the National Taxpayer Advocate can be condensed into one – the adjustment should be clearly supported by highly credible information that is not subject to misinterpretation or ambiguity. Based on these factors, the National Taxpayer Advocate supports expansion similar to that advocated by GAO, in order to enforce lifetime limits on the HOPE scholarship credit under section 25A and the residential energy credit, because the data relied upon to adjust the credit would be IRS records of the prior returns filed by the taxpayer claiming the credit.<sup>263</sup> Supporters of the proposal to expand math error authority would argue that the proposal is consistent with these factors in that the Secretary is authorized to determine the appropriate databases to be used for this proposed authority after taking into account the data's reliability.

The opposing viewpoints requiring expansion of math error authority can be understood as different evaluations of where the balance lies between efficiency gains and possible curtailment of taxpayer protections. The increasing number and complexity of refundable credits and the constraints on IRS access to information needed to verify eligibility for such refunds at the time the return is filed have led to issuance of erroneous refunds, which are difficult to recover. The need to issue refunds promptly in order to avoid paying interest on the refund<sup>264</sup> adds to the pressure to resolve questions during processing in favor of issuing a refund during the filing season.

Fairly recent law changes accelerating the due date of information returns and delaying the refund date for the earned income credit and the additional child tax credit may ease some of this pressure.<sup>265</sup> First, the filing of information on wages reportable on Form W-2 and nonemployee compensation is now due by January 31, generally the same date as the due date for employee and payee statements. Next, no credit or refund for an overpayment for a taxable year is to be made prior to February 15<sup>th</sup> of the year following the calendar year to which the

---

<sup>262</sup> The Taxpayer Advocate makes these recommendations in her 2015, 2014, and 2011 reports. National Taxpayer Advocate, 2015 Annual Report to Congress, vol. 1, pp. 329-339 (Legislative Recommendation No. 2: Math Error Authority: Authorize the IRS to Summarily Assess Math and “Correctible Errors Only in Appropriate Circumstances”); National Taxpayer Advocate, 2014 Annual Report to Congress, vol. 1, pp. 275-310, 284 (Legislative Recommendation No. 1: Taxpayer Rights: Codify Taxpayer Bill of Rights and Enact Legislation that Provides Specific Taxpayer Protections); 2011 Annual Report to Congress, vol. 1, pp. 524-530 (Legislative Recommendation No. 3: Mandate that the IRS, In Conjunction with the National Taxpayer Advocate, Review Proposed Expanded Math Error Authority to Protect Taxpayer Rights).

<sup>263</sup> Government Accountability Office, *IRS Dealt with Challenges to Date, but Needs Additional Authority to Verify Compliance*, (GAO 11-481) March 2011.

<sup>264</sup> Sec. 6611(e) (interest otherwise required to be paid on overpayments of tax does not accrue during a 45-day grace period after a return is filed or deemed filed).

<sup>265</sup> Pub. L. No. 114-133, Div. Q, sec. 201. Effective for returns and statements relating to calendar years beginning in 2016.

taxes relate, if the taxpayer claimed the earned income credit or the additional child tax credit on its tax return.<sup>266</sup> These changes may result in IRS access to documents that are sufficiently clear to identify those cases in which questions are appropriate, but not necessarily so clear that summary assessment authority is appropriate.

Prior to these law changes, most information returns were not available to the IRS until late in the filing season. As a result, in many cases, errors on returns were readily flagged by document matching programs only after the refunds have been issued. How and when to determine whether the issues flagged by matching programs are suitable for assessment without need for examination presents a number of difficult policy choices. The documents used in the various document matching programs are information returns submitted by third parties, including other governmental agencies as well as private entities.<sup>267</sup> Some sources of information returns are more reliable than others, in terms of the accuracy of the preparer of the information returns. Other returns, such as basis reporting (Form 1099-B) or reporting by schools on qualified tuition and related expenses (Form 1098-T), capture information that is relevant to but not determinative of the recipient's tax liability. The recent move to require additional documentation with either the income tax return or with the information returns may result in IRS access to documents that are sufficiently clear to identify those cases in which questions are appropriate, but not necessarily so clear that summary assessment authority is appropriate.

As explained above, the restrictions on assessment generally assure a taxpayer access to administrative review and a pre-payment judicial forum (*i.e.*, the U.S. Tax Court) for reviewing disputed adjustments proposed by the IRS. Assessments made in reliance on math error authority bypass those protections unless the taxpayer requests abatement of the assessment within 60 days. The extent to which affected taxpayers understand this relief from the summary assessment is not clear. According to the Treasury Inspector General for Tax Administration, taxpayers seldom challenge math error assessments, but those who do generally prevail. Few cases requesting abatement are subsequently referred to examination.<sup>268</sup> These data support the contention that math error authority is efficient and operates without prejudice to rights of taxpayers. Information developed by the National Taxpayer Advocate, however, suggests the contrary.<sup>269</sup> The failure to challenge a math error adjustment may not signify agreement with the adjustment, but may instead be a result of taxpayers' failure to understand and timely exercise their rights. After reviewing numerous examples of explanatory paragraphs included in IRS

---

<sup>266</sup> Secs. 6071(c) and 6402(m). Pub. L. No. 114-113, Div. Q, sec. 201.

<sup>267</sup> The existence of an information return in the records of the IRS is a basis for an examination, but is not, in itself, sufficient to sustain an adjustment. Reasonable verification of information returns is required. See section 6201(d).

<sup>268</sup> See Treasury Inspector General for Tax Administration, *Some Taxpayer Responses to Math Error Adjustments Were Not Worked Timely and Accurately*, (TIGTA-2011-40-059) July 7, 2011.

<sup>269</sup> National Taxpayer Advocate, *2018 Annual Report to Congress*, vol. 1, pp. 174-196 (Most Serious Problem No. 12: Math Error Notices: Although the IRS Has Made Some Improvements, Math Error Notices Continue to Be Unclear and Confusing, Thereby Undermining Taxpayer Rights and Increasing Taxpayer Burden; National Taxpayer Advocate.

notices sent to taxpayers to inform them that math error adjustments had been made to their income tax returns, the National Taxpayer Advocate office determined that many were inadequate. Lack of clarity in the notices, whether as to the substance of the adjustment or the availability of any means of recourse, may lead the recipient to allow his or her rights to lapse, and should not be equated with agreement with the adjustment.

## D. Expand Mandatory Electronic Filing of W-2s

### Present Law

The Code authorizes the IRS to prescribe regulations specifying which returns must be filed electronically.<sup>270</sup> There are two limitations on this authority. First, the Code prohibits the Secretary from requiring persons to file returns electronically unless the person is required to file at least 250 returns during the calendar year.<sup>271</sup> Second, in crafting the required regulations, the Secretary is required to take into account the ability of taxpayers to comply at reasonable cost.<sup>272</sup>

The regulations provide rules for when information returns must be filed electronically.<sup>273</sup> Under these rules and consistent with the Code, a person is not required to file a covered information return, such as a Form W-2, *Wage and Tax Statement*, unless the person is required to file 250 or more such returns during the calendar year. The regulations and the examples provide that the 250-return threshold applies separately to each type of information return and each type of corrected information return filed.<sup>274</sup> Thus, the forms are not aggregated for purposes of determining whether the 250-return threshold is satisfied. The Commissioner can waive the requirement to file electronically if the request for waiver demonstrates hardship.<sup>275</sup>

Employers must report wage amounts paid to employees on information returns filed with the SSA and provide the employee with an annual statement showing the aggregate wages paid, taxes withheld, and contact information for the employer.<sup>276</sup> The information returns are required to be filed with the SSA and furnished to the employees on or before January 31 of the year following the calendar year for which the return was required to be made. Employers provide this information to employees on a Form W-2 and submit the Form W-2 to the SSA along with an information return that provides an aggregate summary of wages paid and taxes

---

<sup>270</sup> Sec. 6011(e). The statute uses the term “magnetic media,” and applicable Treasury regulations specify that magnetic media includes electronic filing. Treas. Reg. sec. 301.6011-2(a)(1).

<sup>271</sup> Sec. 6011(e)(2)(A).

<sup>272</sup> Sec. 6011(e)(2)(B).

<sup>273</sup> Treas. reg. sec. 301.6011-2.

<sup>274</sup> Treas. reg. sec. 301.6011-2(c)(1)(i), (iii), and (iv). Note, however, recent proposed regulations remove the non-aggregation rule in § 301.6011-2(c)(1)(iii) that counts the number of information returns required to be filed on a form-by-form basis. 83 Fed. Reg. 24948, May 31, 2018. The proposed regulations provide that if during a calendar year a person is required to file a total of 250 or more information returns of any type covered by § 301.6011-2(b), the person is required to file those information returns electronically. Corrected information returns are not taken into account in determining whether the 250-return threshold is met under the proposed regulations for purposes of determining whether information returns must be filed electronically.

<sup>275</sup> Treas. reg. sec. 301.6011-2(c)(2). The principal factor in determining hardship will be the extent, if any, to which the cost of electronic filing exceeds the cost of filing on other media.

<sup>276</sup> Sec. 6051(a), (e); Treas. reg. sec. 31.6051-2.

withheld on Form W-3, *Transmittal of Wage and Tax Statements*. After it records the Forms W-2 and W-3 wage information in its individual Social Security wage account records, SSA forwards the information on the Forms W-2 and W-3 to the IRS.

### **Description of Proposal**

The proposal requires all employers who file 10 or more Forms W-2 annually to file such forms electronically.<sup>277</sup>

Effective date.—The proposal is effective for taxable years beginning after December 31, 2019.

### **Analysis**

The requirement that employers file electronically only if filing 250 or more information returns dates back 20 years when electronic filing was in the early stages and not as commonly used as today.<sup>278</sup> To the extent employers filed electronically, they used magnetic media or other machine-readable forms.<sup>279</sup> Proponents of reducing the threshold may note that advances in technology have made electronic filing more prevalent and accessible, and less costly, than paper filing. For example, many employers can file for free using the SSA's website.<sup>280</sup> In addition, the increased use of tax return preparers and third-party service providers who offer information return preparation and electronic filing has increased electronic filing. As proof, they would point to the fact that even though not mandated, SSA received approximately 69 million electronically filed Forms W-2 by July 2017 from about 4.4 million employers who filed fewer than 250 Forms W-2.<sup>281</sup>

Proponents may also argue that reducing the threshold would reduce administrative costs for the SSA as well as the IRS. Recent SSA estimates obtained by the Government

---

<sup>277</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item IV.D.

<sup>278</sup> Pub. L. No. 101-239, sec. 7713(a) (1989).

<sup>279</sup> Pub. L. No. 101-239, sec. 7713(a), amended sec. 6011(e), effective for returns the due date for which is after December 31, 1989 (Dec. 19, 1989).

<sup>280</sup> The website allows small businesses to prepare and submit up to 50 W-2s or 25 W-2Cs (per submission) over a secure internet connection. Electronic Wage Reporting (Forms W-2), available at <https://www.ssa.gov/pubs/EN-05-10034.pdf>.

<sup>281</sup> Government Accountability Office, *Tax Fraud and Noncompliance: IRS Can Strengthen Pre-refund Verification and Explore More Uses* (GAO-18-224), January 2018, p. 16.

Accountability Office (“GAO”) indicate that the cost to transcribe and process paper Forms W-2 is \$0.55 per form.<sup>282</sup>

In addition to the cost savings, proponents may argue that the change would help facilitate efficient and effective tax administration by allowing the IRS to obtain timely data from SSA.<sup>283</sup> While they would acknowledge that the accelerated due date (January 31 as of 2017) for the filing of these returns with SSA is helpful, they would likely argue that a change in the threshold is still necessary because of the additional time SSA requires to process paper returns before sending them to the IRS.<sup>284</sup> For example, according to the GAO, it can take the SSA as late as August or September to process paper forms.<sup>285</sup> These backlogs could result in the IRS receiving the data on the forms after the end of the filing season. Consequently, with respect to these paper forms, the IRS does not have the data in time to conduct pre-refund checks of wages (which could uncover underreporting, employment fraud, and other fraud or noncompliance), withholding, and other information before issuing refunds.<sup>286</sup>

Moreover, proponents may argue that increased electronic filing is desirable because even when the IRS receives the W-2 data on paper forms, the information is not immediately useable. The IRS receives the W-2 data from SSA daily but is only able to load the data onto its systems weekly due to its dated information technology.<sup>287</sup> That process can take up to three days or more to complete, depending on the file size of the incoming and existing data, and has prevented the IRS from processing and making the W-2 data available for use, as it is received from SSA.<sup>288</sup>

Lastly, proponents may argue that lowering the threshold helps align the Federal rules with certain States that have passed legislation requiring employers to electronically file Forms W-2 with SSA and electronically furnish to the taxpayer at a lower threshold than 250 returns. In fact, many jurisdictions require the Form W-2 to be electronically filed at significantly lower thresholds than required for Federal purposes. For example, the thresholds

---

<sup>282</sup> *Ibid.*

<sup>283</sup> Government Accountability Office, *Identity Theft: Additional Actions Could Help IRS Combat the Large, Evolving Threat of Refund Fraud* (GAO-14-633), August 2014, pp. 20-21.

<sup>284</sup> Pub. L. No. 114-113, Div. Q, Title II, sec. 201(a). Section 6071(c) requires employers to submit W-2s to the SSA by January 31 which is one month earlier than prior law if filing on paper (previously the last day of February) or two months earlier than prior law if filing electronically (previously March 31).

<sup>285</sup> *Ibid.*, p. 21.

<sup>286</sup> Government Accountability Office, *Tax Fraud and Noncompliance: IRS Can Strengthen Pre-refund Verification and Explore More Uses* (GAO-18-224), January 2018, p. 10.

<sup>287</sup> *Ibid.*, p. 14.

<sup>288</sup> *Ibid.*

are: (i) 25 or more for Alabama,<sup>289</sup> District of Columbia,<sup>290</sup> Mississippi,<sup>291</sup> New Mexico,<sup>292</sup> Vermont,<sup>293</sup> and West Virginia<sup>294</sup> (ii) 50 or more for Louisiana,<sup>295</sup> Nebraska,<sup>296</sup> and Wisconsin;<sup>297</sup> and (iii) 10 or more for North Dakota.<sup>298</sup> In addition, some States such as Oregon<sup>299</sup> and Virginia<sup>300</sup> require all Forms W-2 to be electronically filed.

Opponents of this proposal may argue that the taxpayer burden and cost associated with complying with the reduced threshold outweigh the benefits, particularly with respect to small businesses who do not currently operate in jurisdictions with reduced thresholds for state reporting. For example, small employers that either do not have computer access or have limited access may find it difficult to comply with this requirement. Such employers may find it cost prohibitive to utilize a return preparer or third-party service provider. Thus, without an exemption for certain small employers, this proposal could result in an undue hardship for these taxpayers though this could be mitigated by the IRS' authority to waive the electronic filing requirement if the taxpayer can demonstrate hardship.

---

<sup>289</sup> Ala. Admin. Code r. sec. 810-3-75-.03(1)(b)(1).

<sup>290</sup> D.C. Code sec. 47-1812.08(n)(2)(B).

<sup>291</sup> 35 Miss. Admin. Code Pt. 1, Ch. 04, R. 106(31).

<sup>292</sup> N.M. Stat. Ann. sec. 7-1-71.4(A) (1978).

<sup>293</sup> Vt. Admin. Code 13-1-100:6.I.

<sup>294</sup> W. Va. Code sec. 11-21-74(f).

<sup>295</sup> La. Admin. Code tit. 61, sec. 1515(C).

<sup>296</sup> Neb. Admin. R. secs. 21-007.03, 21-013.01.

<sup>297</sup> Wis. Admin. Code Tax 2.04(6)(a).

<sup>298</sup> N.D. Cent. Code sec. 57-38-60[12].

<sup>299</sup> Or. Admin. R. 150-316-0359(2)(d).

<sup>300</sup> Va. Admin. Code Sec. 58.1-478(c)(2).

## **E. Improve Clarity in Worker Classification Requirements and Information Reporting Requirements**

### **Present Law**

#### **Worker classification**

##### **In general**

The classification of a worker as an employee or not as an employee (that is, as a self-employed individual in most cases) is relevant for many tax purposes, including employment tax requirements, exclusions from gross income for certain types of compensation, and expense deductions. Some purposes favor employee status, while others favor self-employed status. For example, an employee may exclude employer-provided health benefits from gross income. On the other hand, a self-employed individual may deduct work-related expenses in determining adjusted gross income.

##### **Common-law test and section 530 of the Revenue Act of 1978**

The largest body of tax law relating to worker classification has developed in connection with employment taxes.<sup>301</sup> Employment tax responsibility generally rests with the person who is the employer of an employee under a common-law test that has been incorporated into Treasury regulations.<sup>302</sup> Under the regulations, an employer-employee relationship generally exists if the person for whom services are performed has the right to control and direct the individual who performs the services, not only as to the result to be accomplished by the work, but also as to the details and means by which that result is accomplished. That is, an employee is subject to the will and control of the employer, not only as to what is to be done, but also as to how it is to be done. It is not necessary that the employer actually control the manner in which the services are performed, rather it is sufficient that the employer have a right to control. Whether the requisite control exists is determined on the basis of all the relevant facts and circumstances.

Various cases and administrative guidance have identified various facts or factors that are relevant in determining whether an employer-employee relationship exists. Based on an examination of cases and rulings, the Internal Revenue Service (“IRS”) developed a list of 20 factors that may be examined in determining whether an employer-employee relationship exists.<sup>303</sup> The degree of importance of each factor varies depending on the occupation and the factual context in which the services are performed.

---

<sup>301</sup> Employment taxes consist of taxes under the Federal Insurance Contributions Act (“FICA”), secs. 3101-3128, the Railroad Retirement Tax Act (“RRTA”), secs. 3201-3233, and the Federal Unemployment Tax Act (“FUTA”), secs. 3301-3311, and required income tax withholding, secs. 3401-3404.

<sup>302</sup> Treas. Reg. secs. 31.3121(d)-1(c)(1), 31.3306(i)-1(a), and 31.3401(c)-1.

<sup>303</sup> Rev. Rul. 87-41, 1987-1 C.B. 296. The 20 factors identified by the IRS are: (1) instructions, (2) training, (3) integration of the worker’s services into business operations, (4) services to be rendered personally, (5) hiring, supervision, and paying assistants, (6) continuing relationship, (7) set hours of work, (8) full-time services

More recently, the IRS has identified three categories of evidence that may be relevant in determining whether the requisite control exists under the common-law test and has grouped illustrative factors under these three categories: (1) behavioral control; (2) financial control; and (3) relationship of the parties.<sup>304</sup> The IRS emphasizes that factors other than the 20 identified factors may be relevant, that the weight of the factors may vary based on the circumstances, that relevant factors may change over time, and that all facts must be examined.

Generally, individuals who follow an independent trade, business, or profession in which they offer services to the public are not employees. Courts have recognized that a highly educated or skilled worker does not require close supervision; therefore, the degree of day-to-day control over the worker's performance of services is not particularly helpful in determining the worker's status. Courts have considered other factors in these cases, tending to focus on the individual's ability to realize a profit or suffer a loss as evidenced by business investments and expenses.

Under section 530 of the Revenue Act of 1978<sup>305</sup> ("section 530"), if certain requirements are met, a taxpayer may generally treat a worker as not being an employee for employment tax purposes, regardless of the worker's actual status under the common-law test, unless the taxpayer has no reasonable basis for such treatment. For this purpose, a reasonable basis exists if the taxpayer reasonably relied on (1) past IRS audit practice with respect to the taxpayer, (2) published rulings or judicial precedent, (3) long-standing recognized practice in the industry of which the taxpayer is a member, or (4) any other reasonable basis. Relief under section 530 also requires that the taxpayer not have treated the worker as an employee for any period, and, for periods after 1978, all Federal tax returns, including information returns, must have been filed on a basis consistent with treating the worker as not being an employee. Further, the taxpayer (or a predecessor) must not have treated any worker holding a substantially similar position as an employee for purposes of employment taxes for any period beginning after 1977.

Section 530 also generally prohibits Treasury and the IRS from publishing regulations and revenue rulings with respect to the employment status of any individual for employment tax purposes. However, a service provider or service recipient may generally obtain a written determination from the IRS regarding the status of a particular worker as an employee or

---

required, (9) work on service recipient's premises, (10) required order or sequence of work, (11) oral or written reports required, (12) payment by the hour, week, or month, (13) payment of business or travel expenses, (14) furnishing of tools and materials by service recipient, (15) significant investment by the worker, (16) ability to realize a profit or loss by the worker, (17) working for more than one firm at a time, (18) services available to the general public, (19) service recipient has right to discharge, and (20) worker has right to terminate relationship.

<sup>304</sup> Department of the Treasury, Internal Revenue Service, *Independent Contractor or Employee? Training Materials*, Training 3320-102 (10-96) TPDS 84238I, pp. 2-7. This document is publicly available through the IRS website.

<sup>305</sup> Pub. L. No. 95-600. The relief provided under section 530 was initially temporary to give Congress time to resolve the many complex issues regarding worker classification. However, after being extended more than once, it was made permanent and has been amended several times over the years.

independent contractor for purposes of Federal employment taxes and income tax withholding.<sup>306</sup>

### Statutory employee or nonemployee status

The Code contains various provisions that prescribe treatment of a specific category or type of worker as an employee or as not being an employee. Some of these provisions apply for Federal tax purposes generally; for example, certain real estate agents and direct sellers are treated for all tax purposes as not being employees.<sup>307</sup> Others apply only for specific purposes; for example, full-time life insurance salesmen are treated as employees for social security and Medicare tax and employee benefit purposes,<sup>308</sup> and certain other salesmen are treated as employees for social security and Medicare tax purposes.<sup>309</sup>

### Reporting requirements

Present law requires persons to file an information return concerning certain transactions with other persons.<sup>310</sup> The person filing an information return is also required to provide the recipient of the payment with a written statement showing the aggregate payments made and the contact information for the payor.<sup>311</sup> These returns are intended to assist taxpayers in preparing their income tax returns and to help the IRS determine whether such income tax returns are correct and complete.

### Returns relating to payments made of fixed or determinable income or compensation and returns relating to payments for services

One of the primary provisions governing information reporting by payors requires every person engaged in a trade or business who makes payments aggregating \$600 or more in any taxable year to a single payee in the course of the payor's trade or business to file a return

---

<sup>306</sup> IRS Form SS-8 (Rev. 11-2006). A written determination with regard to prior employment status may be issued by the IRS. The IRS will not issue a written determination with respect to prospective employment status. Section 3.01(109) of Rev. Proc. 2019-3, 2019-1 I.R.B. 130, 136. Under section 7436, if the IRS determines that a worker is an employee for employment tax purposes of the person for whom services are performed, or that the person is not entitled to relief under section 530, the person may petition the Tax Court for a determination of whether the IRS determination is correct and the proper amount of employment tax.

<sup>307</sup> Sec. 3508.

<sup>308</sup> Secs. 3121(d)(3)(B) and 7701(a)(20).

<sup>309</sup> Sec. 3121(d)(3)(D).

<sup>310</sup> Secs. 6031 through 6060.

<sup>311</sup> Sec. 6041(d).

reporting these payments.<sup>312</sup> The information return generally is submitted electronically as a Form 1099 (e.g., IRS Form 1099-MISC, Miscellaneous Income) or Form 1096, Annual Summary and Transmittal of U.S. Information Returns.

Certain payments subject to information reporting also are subject to backup withholding if the payee has not provided a valid taxpayer identification number. Payments to corporations generally are excepted from this requirement. Payments subject to reporting include fixed or determinable income or compensation, but do not include payments for goods or certain enumerated types of payments that are subject to other specific reporting requirements.<sup>313</sup> Other reporting requirements are provided for the reporting of various types of investment income, including interest, dividends, and gross proceeds from brokered transactions (such as a sale of stock) paid to U.S. persons.<sup>314</sup>

Other information reporting requirements cover employers required to deduct and withhold tax from employees' income.<sup>315</sup> Payors must report wage amounts paid to employees on information returns filed with the Social Security Administration and provide the employee with an annual statement showing the aggregate wages paid, taxes withheld, and contact information for the payor.<sup>316</sup>

The payor of amounts described above is required to furnish the recipient of the payment with the annual statement on or before January 31 of the year following the calendar year for which the return was required to be made.<sup>317</sup> The due date by which the payor must file the information return depends on the information being reported. For example, payors must file information returns with respect to wages reportable on Form W-2 and nonemployee compensation on the same date as the due date for employee and payee statements, namely on or

---

<sup>312</sup> Certain payments to beneficiaries or employees may require use of Form 1041 or Forms W-2 and W-3, respectively. Treas. Reg. sec. 1.6041-1(a)(2).

<sup>313</sup> Sec. 6041(a) requires reporting as to fixed or determinable gains, profits, and income (other than payments to which secs. 6042(a)(1), 6044(a)(1), 6047(c), 6049(a), or 6050N(a) applies and other than payments with respect to which a statement is required under authority of section 6042(a), 6044(a)(2) or 6045). These payments excepted from section 6041(a) include most interest, royalties, and dividends. Also, there is a different reporting requirement in section 6041A that provides that any service recipient engaged in a trade or business and paying for services is required to make a return according to regulations when the aggregate of payments is \$600 or more.

<sup>314</sup> Secs. 6042 (dividends), 6045 (broker reporting) and 6049 (interest) and the Treasury regulations thereunder.

<sup>315</sup> Sec. 6051(a).

<sup>316</sup> The information return is submitted to employees on a Form W-2, Wage and Tax Statement. The payors are also required to submit the Form W-2 to the Social Security Administration ("SSA") along with an information return that provides an aggregate summary of wages paid and taxes withheld on Form W-3, Transmittal of Wage and Tax Statements. After it records the Forms W-2 and W-3 wage information in its individual Social Security wage account records, SSA forwards the Forms W-2 and W-3 information to IRS.

<sup>317</sup> See, e.g., secs. 6041(d), 6041A(e).

before January 31 of the following calendar year.<sup>318</sup> However, all other information returns, including returns relating to payments made in settlement of payment card and third party network transactions discussed below, are required to be filed by payors with the IRS on or before February 28 of the year following the calendar year for which the return must be filed.<sup>319</sup> And if these other information returns are filed electronically, the filing due date is March 31.<sup>320</sup>

Any person who is required to file an information return or furnish a payee statement but who fails to do so on or before the prescribed due date is subject to a penalty that varies based on when, if at all, the correct information return is filed or furnished. There are penalties imposed for failure to file the information return,<sup>321</sup> furnish payee statements,<sup>322</sup> or comply with other various reporting requirements.<sup>323</sup> No penalty is imposed if the failure is due to reasonable cause.<sup>324</sup> Both the failure to file and failure to furnish penalties are adjusted annually to account for inflation.

There is a \$100 *de minimis* error threshold (lowered to \$25 for an error with respect to reporting an amount of withholding or backup withholding) under which the penalties for failure to file and failure to furnish accurate information returns and payee statements do not apply.<sup>325</sup> Payees, however, can still elect to receive accurate payee statements, in which case the *de minimis* threshold does not apply to the penalties for failure to file and furnish.

---

<sup>318</sup> Sec. 6071(c). There is no longer a 30-day automatic extension of time to file information returns that report wages (the Form W-2 series, except Form W-2G), or to file information returns that report nonemployee compensation (currently Forms 1099-MISC with information in box 7). Taxpayers filing these forms may continue to request one non-automatic 30-day extension of time to file the information returns. Treas. Reg. sec. 1.6081-8(b) (effective for requests for extension of time to file certain information returns due after December 31, 2018). See also, Treas. Reg. sec. 1.6081-8T (effective for requests for extension of time to file certain information returns due after December 31, 2016 and before January 1, 2019).

<sup>319</sup> Treas. Reg. sec. 1.6041-6T. The regulations provide in relevant part “Except as provided in paragraph (b) of this section, returns, made under section 6041 on Forms 1096 and 1099 for any calendar year shall be filed on or before February 28 (March 31 if filed electronically) for the following year...(b) Exception. Returns made on Form 1099 reporting nonemployee compensation shall be filed on or before January 31 of the year following the calendar year to which such returns relate.”

<sup>320</sup> Treas. Reg. sec. 1.6041-6T. Section 6071(b) applies to “returns made under subpart B of part III of this subchapter (other than returns and statements required to be filed with respect to nonemployee compensation)”; Treas. Reg. sec. 301.6011-2(b) mandates use of magnetic media by persons filing information returns identified in the regulation or subsequent or contemporaneous revenue procedures and permits use of magnetic media for all others.

<sup>321</sup> Sec. 6721.

<sup>322</sup> Sec. 6722.

<sup>323</sup> Sec. 6723. The penalty for failure to comply timely with a specified information reporting requirement is \$50 per failure, not to exceed \$100,000 per calendar year.

<sup>324</sup> Sec. 6724.

<sup>325</sup> Secs. 6721(c)(3), 6722(c)(3).

## Returns relating to payments made in settlement of payment card and third party network transactions

Starting in 2012 (for payments received in 2011), payment settlement entities are required to report the gross amount of payments made in settlement of payment card transactions and third party network transactions to the IRS and businesses that receive these payments.<sup>326</sup>

Specifically, the statute requires any payment settlement entity making payment to a participating payee in settlement of reportable payment transactions to report annually to the IRS and to the participating payee the gross amount of such reportable payment transactions, as well as the name, address, and TIN of the participating payees. A “reportable payment transaction” means any payment card transaction and any third party network transaction.

A “payment settlement entity” means, in the case of a payment card transaction, a merchant acquiring entity and, in the case of a third party network transaction, a third party settlement organization. A “participating payee” means, in the case of a payment card transaction, any person who accepts a payment card as payment and, in the case of a third party network transaction, any person who accepts payment from a third party settlement organization in settlement of such transaction.

For purposes of the reporting requirement, the term “merchant acquiring entity” means the bank or other organization with the contractual obligation to make payment to participating payees in settlement of payment card transactions. A “payment card transaction” means any transaction in which a payment card is accepted as payment.<sup>327</sup> A “payment card” is defined as any card (*e.g.*, a credit card or debit card) which is issued pursuant to an agreement or arrangement which provides for: (1) one or more issuers of such cards; (2) a network of persons unrelated to each other, and to the issuer, who agree to accept such cards as payment; and (3) standards and mechanisms for settling the transactions between the merchant acquiring entities and the persons who agree to accept such cards as payment. Thus, under the provision, a bank that enrolls a business to accept credit cards and contracts with the business to make payment on credit card transactions is required to report to the IRS the business’s gross credit card transactions for each calendar year on a Form 1099-K, Payment Card and Third Party Network Transactions. The bank also is required to provide a copy of the information report to the business.

The statute also requires reporting on a third party network transaction. The term “third party network transaction” means any transaction which is settled through a third party payment network. A “third party payment network” is defined as any agreement or arrangement: (1) which involves the establishment of accounts with a central organization by a substantial number of persons (*e.g.*, more than 50) who are unrelated to such organization, provide goods or

---

<sup>326</sup> Sec. 6050W. The Housing and Economic Recovery Act of 2008, Pub. L. No. 110-289 (2008), sec. 3091(a), added sec. 6050W, effective generally for returns for calendar years beginning after December 31, 2010.

<sup>327</sup> For this purpose, the acceptance as payment of any account number or other indicia associated with a payment card also qualifies a payment card transaction.

services, and have agreed to settle transactions for the provision of such goods or services pursuant to such agreement or arrangement; (2) which provides for standards and mechanisms for settling such transactions; and (3) which guarantees persons providing goods or services pursuant to such agreement or arrangement that such persons will be paid for providing such goods or services. In the case of a third party network transaction, the payment settlement entity is the third party settlement organization, which is defined as the central organization which has the contractual obligation to make payment to participating payees of third party network transactions. Thus, an organization generally is required to report if it provides a network enabling buyers to transfer funds to sellers who have established accounts with the organization and have a contractual obligation to accept payment through the network. However, an organization operating a network which merely processes electronic payments (such as wire transfers, electronic checks, and direct deposit payments) between buyers and sellers, but does not have contractual agreements with sellers to use such network, is not required to report. Similarly, an agreement to transfer funds between two demand deposit accounts will not, by itself, constitute a third party network transaction.

A third party payment network does not include any agreement or arrangement which provides for the issuance of payment cards as defined by the provision. In addition, there is an exception for *de minimis* payments that applies to payments made by third party settlement organizations but not to payments made by merchant acquiring entities. A third party settlement organization is not required to report unless the aggregate value of third party network transactions with respect to a taxpayer for the year exceeds \$20,000 and the aggregate number of such transactions with respect to a taxpayer exceeds 200.<sup>328</sup> If a payment of funds is made to a third party settlement organization by means of a payment card (*i.e.*, as part of a transaction that is a payment card transaction), the \$20,000 and 200 transaction *de minimis* rule continues to apply to any reporting obligation with respect to payment of such funds to a participating payee by the third party settlement organization made as part of a third party network transaction.

So, for example, if a business that provides a web-based rental platform for short-term travelers is considered a third party settlement organization, it does not have to provide a Form 1099-K to property owners participating on their web-based site who have received payments of \$20,000 or less. On the other hand, if that company is considered a merchant acquiring entity it would have to issue a Form 1099-K to all payees participating on its platform who have received payments of any amount starting with the first dollar.

There are also reporting requirements on intermediaries who receive payments from a payment settlement entity and distribute such payments to one or more participating payees. Such intermediaries are treated as participating payees with respect to the payment settlement entity and as payment settlement entities with respect to the participating payees to whom the intermediary distributes payments. Thus, for example, in the case of a corporation that receives payment from a bank for credit card sales effectuated at the corporation's independently-owned franchise stores, the bank is required to report the gross amount of reportable payment transactions settled through the corporation (notwithstanding the fact that the corporation does not accept payment cards and would not otherwise be treated as a participating payee). In turn,

---

<sup>328</sup> Sec. 6050W(e).

the corporation, as an intermediary, would be required to report the gross amount of reportable payment transactions allocable to each franchise store. The bank would have no reporting obligation with respect to payments made by the corporation to its franchise stores.

Another rule provides that if a payment settlement entity contracts with a third party to settle reportable payment transactions on behalf of the payment settlement entity, the third party is required to file the annual information return in lieu of the payment settlement entity.

The payment settlement entity is required to file the information return to the IRS on or before February 28<sup>th</sup> (March 31<sup>st</sup> if filing electronically) of the year following the calendar year for which the return must be filed.<sup>329</sup> The statements are required to be furnished to the participating payees on or before January 31 of the year following the calendar year for which the return was required to be made.<sup>330</sup>

The Secretary has exercised authority under these rules to issue guidance to implement the reporting requirement, including rules to prevent the reporting of the same transaction more than once.<sup>331</sup>

The reportable payment transactions subject to information reporting generally are subject to backup withholding requirements. In addition, the information reporting penalties described in the section above apply for any failure to file a correct information return or furnish a correct payee statement with respect to the reportable payment transactions.

## **Description of Proposal**

### **Worker classification safe harbor**

#### **In general**

The proposal<sup>332</sup> provides a safe harbor under which, for all Code purposes (and notwithstanding any Code provision to the contrary), if certain requirements are met with respect to service performed by a service provider, with respect to such service: (1) the service provider is not treated as an employee, (2) the service recipient is not treated as an employer, (3) a payor

---

<sup>329</sup> Treas. reg. sec. 1.6050W-1(g). Taxpayers that file these information returns that report reportable payment transactions are entitled to a 30-day automatic extension of time to file. Treas. Reg. sec. 1.6081-8(a) (effective for requests for extension of time to file certain information returns due after December 31, 2016).

<sup>330</sup> Sec. 6050W(f); Treas. reg. sec. 1.6050W-1(h).

<sup>331</sup> Treas. Reg. sec. 1.6050W-1(a)(4)(ii).

<sup>332</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item IV.E.

is not treated as an employer, and (4) the compensation paid or received for the service is not treated as paid or received with respect to employment.<sup>333</sup>

For purposes of the proposal, a service provider is any qualified person who performs service for another person, and a qualified person is any natural person or any entity if any of the services performed for another person are performed by one or more natural persons who directly own interests in such entity. The service recipient is the person for whom the service provider performs service. A payor is a person (including the service recipient) that:

1. pays the service provider for performing the service, or any third party settlement organization which is the central organization which has the contractual obligation to make payment to participating payees of third party network transactions;
2. who enters into an agreement with each provider that such provider will not be treated as an employee with respect to such goods and services; and
3. who provides standards and mechanisms for settling such transactions, and guarantees each service provider of payment for transactions.<sup>334</sup>

The proposal does not apply with respect to any service provided by a service provider to a service recipient or payor if the service provider owns any direct or indirect interest of greater than one percent in the service recipient or payor, with the exception of a service recipient or payor the stock of which is regularly traded on an established securities market.

Under the proposal, notwithstanding section 530, the Secretary of the Treasury is directed to issue such regulations as the Secretary determines are necessary to carry out the purposes of the proposal. Nothing in the proposal is to be construed as limiting the ability or right of a service provider, service recipient, or payor to apply any other Code provision, section 530, or any common law rules for determining whether an individual is an employee, or as establishing a prerequisite for the application of any of those areas of law.

#### Service provider requirements

In order for this treatment to apply to service, in connection with performing the service, the service provider generally must:

1. incur expenses which are deductible as trade or business expenses and a significant portion of which are not reimbursed;

---

<sup>333</sup> The proposal also amends the direct seller rules under section 3508 to include a person engaged in the trade or business of selling, or soliciting the sale of, promotional products from other than a permanent retail establishment. For this purpose, a promotional product is a tangible item with permanently marked promotional words, symbols, or art of the purchaser.

<sup>334</sup> The proposal amends section 7436 to allow a petition to be filed by a service recipient, a payor, or a service provider whom the IRS has determined should have been treated as an employee.

2. agree to perform the service for a particular amount of time, to achieve a specific result, or to complete a specific task; and
3. have a significant investment in assets or training applicable to the service performed, not be required to perform services exclusively for the service recipient, have not performed substantially the same services for the service recipient or payor as an employee during the one-year period ending with the date of commencement of services under a contract meeting the requirements described below, or not be compensated on a basis which is tied primarily to the number of hours actually worked.

Alternatively, in the case of a service provider engaged in the trade or business of selling (or soliciting the sale of) goods or services, the service provider must be compensated primarily on a commission basis, and substantially all the compensation for the service must be directly related to sales of goods or services rather than to the number of hours worked. In addition, any service provider must have a principal place of business, must not primarily provide the service in the service recipient's place of business, must pay a fair market rent for use of the service recipient's place of business, or must provide the service primarily using equipment supplied by the service provider.

#### Contract and reporting requirements

To qualify for the safe harbor, the service performed by the service provider must be pursuant to a written contract between the service provider and the service recipient (or the payor, if applicable) that meets the following requirements:

1. the contract must include the service provider's name, taxpayer identification number, and address;
2. a statement that the service provider will not be treated as an employee for purposes of the Code with respect to the service provided pursuant to the contract;
3. a statement that the service recipient (or the payor) will, consistent with Code requirements, withhold on and report to the IRS the compensation payable pursuant to the contract;
4. a statement that the service provider is responsible for the payment of Federal, State, and local taxes, including self-employment taxes, on compensation payable pursuant to the contract; and
5. a statement that the contract is intended to be a contract meeting the applicable requirements.

The contract does not fail to meet these requirements merely because the service provider's name, taxpayer identification number, and address are collected at the time of payment for the services and not in advance, or because the contract provides for an agent of the service recipient or payor to fulfill the responsibilities of the service recipient or payor. Second, the term of the contract generally must not exceed two years; however, a contract can be

renewed in writing one or more times if the term of each renewal does not exceed two years and if the required information in the contract is updated in connection with the renewal. Third, the contract or renewal must be signed, including electronically, by both the service recipient or payor and the service provider no later than the date on which aggregate payments made by the service recipient to the service provider exceed \$1,000.

If, for a taxable year, the service recipient or payor fails to meet the reporting requirements applicable with respect to any service provider (“applicable” reporting requirements),<sup>335</sup> the safe harbor does not apply for purposes of making any determination with respect to the tax liability of the service recipient or payor with respect to such service provider for the year (unless the failure is due to reasonable cause and not willful neglect).

#### Prospective application of reclassification

In the case of a determination by the IRS that a service recipient or a payor should have treated a service provider as an employee, if certain requirements are met, the determination will not be effective earlier than the “notice date.” In order for this rule to apply:

1. the service recipient or payor must have entered into a written contract with the service provider that meets the requirements described above;
2. for all relevant taxable years the service recipient or the payor must have satisfied the applicable withholding and reporting requirements with respect to the service provider (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect);
3. the service recipient or payor must have collected and paid over all applicable employment taxes for all relevant taxable years with respect to the service provider (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect); and
4. the service recipient or the payor must demonstrate a reasonable basis for determining that the service provider is not an employee under the safe harbor and that the determination was made in good faith.

---

<sup>335</sup> The applicable reporting requirements relate to, under section 6041(a), a person engaged in a trade or business that makes payments of \$600 or more (\$1,000 or more under the proposal, as discussed below) to another person, under section 6041A(a), a service recipient engaged in a trade or business that pays \$600 or more (\$1,000 or more under the proposal, as discussed below) in remuneration to another person for services, or under section 6050W(a), a third party settlement organization settling payments above the minimum threshold (more than \$1,000 under the proposal) with a provider of goods or services engaging in third party network transactions. Under the proposal, reporting by a service recipient or payor required under section 6041, 6041A, or 6050W with respect to compensation paid under the proposal must include the aggregate amount of such compensation paid to each person whose name is required to be included on the report, the aggregate amount of income tax withheld from the compensation (as discussed below), and an indication of whether a copy of the contract required under the proposal is on file with the service recipient or payor.

Similarly, with respect to the service provider, a determination that the service provider should have been treated as an employee will not be effective earlier than the notice date if the service provider entered into a written contract with the service recipient or payor that meets the requirements described above, for all relevant taxable years the service provider satisfied applicable income tax and self-employment tax return requirements<sup>336</sup> with respect to the service recipient or payor (unless the failure to satisfy the requirements is due to reasonable cause and not willful neglect), and the service provider demonstrates a reasonable basis for determining that the service provider is not an employee under the safe harbor and that the determination was made in good faith.

For this purpose, the “notice date” is the 30th day after the earlier of (1) the date on which the first letter of proposed deficiency that allows the service provider, service recipient, or payor an opportunity for administrative review in the IRS Office of Appeals is sent, (2) the date on which a deficiency notice is sent, or (3) the date on which a notice of determination that a service provider is an employee is sent.

#### Withholding requirements

The proposal imposes an income tax withholding requirement with respect to compensation paid pursuant to a contract between a service provider and a service recipient (or payer) that meets the requirements described above. For this purpose, a payment of such compensation is treated as a payment of wages by an employer to an employee. However, the amount required to be withheld is five percent of the compensation and only on compensation up to \$20,000 paid pursuant to the contract.<sup>337</sup>

Effective date.—The proposal is effective for services provided after December 31, 2019.

### **Reporting requirements**

#### Returns relating to payments made of fixed or determinable income or compensation and returns relating to payments for services

The proposal increases the reporting threshold for two categories of reportable payments from aggregate payments of \$600 or more to \$1,000 or more. The first category is payments of fixed or determinable income or compensation not including payments for goods or certain enumerated types of payments subject to other reporting requirements. The second category is payments for services received from any service recipient engaged in a trade or business who makes payments of remuneration in the course of that trade or business to any person for services performed.

---

<sup>336</sup> Secs. 6012(a) and 6017.

<sup>337</sup> The proposal also amends the voluntary withholding rules under section 3402(p) to provide that a voluntary withholding agreement is not taken into account in determining whether any party to the agreement is an employee or an employer for Code purposes.

Returns relating to payments made in settlement of payment card and third party network transactions

The proposal accelerates the filing of information returns on reportable payment transactions by requiring that payment settlement entities file these information returns with the IRS by January 31 of the following year, the same date as the due date for furnishing statements to participating payees, regardless of whether these information returns are filed on paper or electronically. The proposal also provides that such returns are no longer eligible for the 30-day automatic extension of time to file currently provided in the Treasury regulations.

This proposal also narrows the *de minimis* exception for aggregate third party network transactions to a participating payee below which a third party settlement organization is not required to report. Under the proposal, a third party settlement organization is required to report third party network transactions with any participating payee that exceed a minimum threshold of \$1,000 in aggregate payments, regardless of the aggregate number of such transactions.

Effective date.—The proposal is effective for payments made after December 31, 2019.

**Analysis**

**Worker classification and the contingent work force**

Ambiguity in the Code has led to different interpretations of IRS classification and reporting standards for workers in alternative employment arrangements, such as those earning money through “gig” economy platforms. Classification of these workers as independent contractors or employees is dependent upon a number of factors. While workers who earn a salary or hourly wages and who receive a Form W-2 from their employer at the end of the year and have income and employment taxes withheld during the year are generally treated as employees, independent contractors have their income reported on a Form 1099 and generally do not have income taxes withheld.<sup>338</sup> In addition, independent contractors are responsible for both halves of the federal payroll taxes that fund Social Security and Medicare, while employees have half of those taxes paid by their employer.<sup>339</sup> Under the current reporting requirements, further complications arise where payments to the individuals are made by credit card. A recent study<sup>340</sup>

---

<sup>338</sup> However, generally such independent contractors have to make quarterly estimated tax payments and file a Form 1040-ES, Estimated Tax for Individuals, with the IRS.

<sup>339</sup> Many economists believe, however, that the tax burden will ultimately fall upon the employee in either scenario. See, e.g., Jonathan Gruber, “The Incidence of Payroll Taxation: Evidence from Chile,” National Bureau of Economic Research, NBER Working Paper Series, Working Paper No. 5053, March 1995.

<sup>340</sup> Caroline Bruckner, “Shortchanged: The Tax Compliance Challenges of Small Business Operators Driving the On-Demand Platform Economy,” Kogod Tax Policy Center, May 2016, available at <https://www.american.edu/kogod/research/upload/shortchanged.pdf>. See also, Inspector General for Tax Administration, Department of the Treasury, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (TIGTA-2019-30-016), February 14, 2019 available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf> and Inspector General for Tax Administration, Department of the Treasury, *Improvements to the SS-8 Program Are Needed to Help Workers and Improve Employment Tax Compliance* (TIGTA-2018-30-077), September 19, 2018 (The SS-8 Program “lacks

estimated that more than 2.5 million U.S. taxpayers are participating in the “gig” or on-demand platform economy. The study reported that 34 percent of those earning money in the “gig” economy did not know whether they needed to file quarterly estimated tax payments; 36 percent did not understand what records they would need to maintain as a small business for tax purposes; 43 percent did not set aside money to meet their obligations or know how much they owed; in 2015, more than 60 percent did not receive a Form 1099-K or Form 1099-MISC from their on-demand platform; and 69 percent did not receive any tax guidance or advice from the “gig” economy platform they used to earn their income.

#### Alternative employment arrangements.

The proposal is intended to provide clarity in worker classification and information reporting requirements for all individuals but with a particular focus on freelance-style workers in both traditional independent contractor arrangements, including computer consultants, freelance writers and delivery drivers, as well as all of those individuals who participate in the “gig” economy and provide a wide variety of services.

The Bureau of Labor Statistics (“BLS”) provides the following description of contingent and alternative employment arrangements:

Contingent workers are persons who do not expect their jobs to last or who report that their jobs are temporary....Contingent workers are those who do not have an implicit or explicit contract for ongoing employment. Alternative employment arrangements include persons employed as independent contractors (whether identified as independent contractors, independent consultants, or freelance workers, and regardless of whether they are self-employed or wage and salary workers), on-call workers (workers who are called to work only as needed, although they can be scheduled to work for several days or weeks in a row), temporary help agency workers, and workers provided by contract firms.<sup>341</sup>

Supporters of the proposal argue that an employer does not control the work of these contingent workers and as a result, these workers should not be classified as employees. Arrangements for contingent workers include some characteristics suggesting independent contractor status, such as a short-term relationship and less than full-time schedule or irregular hours. Accordingly, businesses create jobs for contingent workers with the objective of providing different compensation packages and working conditions for these workers as opposed to those provided to employees, for example, the ability of such businesses not to have to provide

---

guidance about workers in the “gig” economy”) available at <https://www.treasury.gov/tigta/auditreports/2018reports/201830077fr.pdf>.

<sup>341</sup> Bureau of Labor Statistics, *Contingent and Alternative Employment Arrangements Summary -- May 2017*, available at <https://www.bls.gov/news.release/conemp.nr0.htm>.

minimum wage and overtime premium pay to such workers or not to provide these workers the right to join a union and engage in collective bargaining.<sup>342</sup>

Opponents of the proposal argue that contingent workers are in a weaker position to oppose their classification as independent contractors. They argue that contingent workers may be workers with few other employment opportunities. They argue that an employer may be willing to give up control (or at least the semblance of control) to gain the advantage of treating contingent workers as independent contractors, and that employers may specifically design these jobs to avoid the appearance of having the requisite control to compel a classification of employee. Because the determination of employee status is inherently factual and includes subjective determinations, employers may be able to structure the arrangement with contingent workers so that it is more difficult to argue that a classification of a contingent worker as an independent contractor is improper. They point out that contingent workers, wrongly classified as independent contractors, may be unwilling to complain for fear of retaliation by their employer (regardless of the protection Federal law may accord the employee against such reprisal).<sup>343</sup> They also argue that there are financial incentives for an employer to classify workers as independent contractors whenever possible.<sup>344</sup>

Supporters of the proposal argue that many workers choose to be contingent workers and that the workers actually prefer their alternative work arrangements, including their status as independent contractors, to traditional jobs.<sup>345</sup> They argue that there should not be a bias in the

---

<sup>342</sup> Catherine K. Ruckelshaus, "Labor's Wage War," *Fordham Urban Law Journal*, vol. 35, 2008, pp. 373-407.

<sup>343</sup> *Ibid.*, p. 384, footnote 63 (pointing out that fear of reprisal prevents complaints with respect to wage and hour law violations despite the Fair Labor Standards Act (FLSA) prohibition against such reprisal).

<sup>344</sup> *Ibid.*, p. 381 ("By misclassifying its employees, employers stand to save upwards of 30% of their payroll costs, including employer-side FICA and FUTA tax obligations, worker's compensation and state unemployment, and disability taxes paid for employees"). However, economists generally conclude that regardless of the statutory incidence, the burden of the payroll tax is generally born by the worker regardless of whether the worker is categorized as an employee or an independent contractor. See Jonathan Gruber, "The Incidence of Payroll Taxation: Evidence from Chile," National Bureau of Economic Research, NBER Working Paper Series, Working Paper No. 5053, March 1995.

<sup>345</sup> Marisa DiNatale, "Characteristics of and preferences for alternative work arrangements, 1999" *Monthly Labor Review*, March 2001, pp. 28-49. The article describes the results of BLS 1999 Contingent and Alternative Work Arrangement Survey in which it found that one third of independent contractors in this category held a college degree and 12 percent held an advanced degree. The article points out that these proportions are slightly lower for traditional workers for the same time period which the article indicates is 31 percent college graduates and for which 10 percent held advanced degrees. The article also points out that compared with traditional workers, independent contractors at that time were more likely to be men, older, and white. The article indicates that, at least in 1999, the overwhelming majority of independent contractors were reported to be very happy in their arrangement and entered it voluntarily. Under the survey, about 84 percent of independent contractors reported that they preferred their arrangement to a traditional one in February 1999. A BLS News Release (USDL 05-1433), "Contingent and Alternative Employment Arrangements, February 2005," dated July 27, 2005, reports similar conclusions with respect to independent contractors in 2005. However, a GAO Report, "Contingent Workforce: Size, Characteristics, Earnings and Benefits" (GAO-15-168R, April 20, 2015) reaches a different conclusion indicating

law against classifying a worker as an independent contractor in an appropriately structured business relationship between the worker and the business. Thus, they would argue that the contingent work force should not be a specific target for published guidance.

### **Worker classification safe harbor**

The proposal sets forth a safe harbor test for the determination of whether certain workers (including contingent workers in the “gig” economy) will be treated as independent contractors for purposes of the Code as noted above, relying upon factors that are intended to demonstrate the independence of the service provider from the service recipient and/or the payor, rather than the subjective facts and circumstances analysis under present law.

Supporters of the proposed safe harbor argue that such a safe harbor is needed in order to give businesses some certainty that their classifications will not be challenged by the IRS. Supporters also argue that a safe harbor based on objective criteria is needed to allow businesses to classify these workers as independent contractors and make legal arrangements in a manner consistent with their competitors rather than having to make an independent judgment and potentially being placed at a competitive disadvantage.

Opponents of the proposed safe harbor argue that for individuals working in the “gig” economy, the safe harbor should be designed to treat such individuals as employees rather than independent contractors because of the complexity of the current tax system and lack of knowledge and resources available to these workers. Many of these workers may not have extensive knowledge of their tax obligations.<sup>346</sup> As independent contractors, they may have a significant tax compliance burden. They may face potentially large tax bills and be forced to seek expensive professional tax assistance which they cannot afford.<sup>347</sup> Placing the burden of complying with these tax obligations on the companies, as these opponents suggest, would require the companies to mandatorily withhold income taxes from these individuals’ income, which they argue would result in increased compliance within the tax system. The proposal does require such companies to withhold an amount equal to five percent of compensation that does not exceed \$20,000 where the worker is classified as an independent contractor. Opponents of the proposal would argue that while this withholding (and reporting) is sufficient to identify the independent contractor to the IRS, the proposal should use the regular wage withholding scale and withholding should not stop at \$20,000. On the other hand, a reason to use a lower withholding rate is that the withholding is on the gross amount while wage withholding and estimated taxes are based on net income.

---

that “because contingent work can be unstable or afford fewer worker protections...it tends to lead to lower earnings, fewer benefits, and a greater reliance on public assistance than standard work.”

<sup>346</sup> Inspector General for Tax Administration, Department of the Treasury, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (TIGTA-2019-30-016), February 14, 2019, p. 34, available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf>.

<sup>347</sup> Shu-Yi Oei and Diane M. Ring, “The Tax Lives of Uber Drivers: Evidence from Internet Discussion Forums,” *Boston College Law School Legal Studies Research Paper Series*, Research Paper 391, February 10, 2016.

Opponents of the safe harbor also argue that it applies only for tax purposes. As a result, if a worker is treated by the business as an independent contractor under the safe harbor, the worker may mistakenly believe he or she is in fact an independent contractor for all purposes (for example, including workers' compensation, unemployment, Fair Labor Standards Act ("FLSA") purposes, etc.). If an employee is classified as an independent contractor for tax purposes, it may be more difficult for other Federal agencies and employees to challenge that classification for purposes outside the context of taxes.<sup>348</sup> A worker may not understand that he or she is an employee for purposes of other Federal law, such as the FLSA, or may feel powerless to assert the right to be classified as an employee rather than as an independent contractor.<sup>349</sup>

### **Common-law test**

Given that the safe harbor is based on objective criteria, it may not apply in every case. The bill preserves the common law rules for worker classification as well as certain provisions under current law, for example certain provisions for direct sellers, where the safe harbor may not apply.

Opponents of the common-law test point out that a major source of the confusion regarding classification of a worker is that the common-law test requires an examination of a variety of factors that often do not result in a clear answer. Although the proper classification of a worker is clear in many circumstances, close cases create uncertainty.<sup>350</sup> They argue that a more objective standard is needed for worker classification that leaves fewer situations unclear.

Opponents of the common-law test also argue that the test, when combined with what they characterize as the bias of the IRS toward classification of workers as employees, leaves businesses vulnerable to being challenged by IRS agents on audit. However, others argue that the common-law test places too great an emphasis on "control" by businesses and can be manipulated by them leading to more individuals being classified as independent contractors. They argue that a test that expands the workers that must be classified as employees may be

---

<sup>348</sup> There is even a question as to whether a business's classification of a worker as an independent contractor should apply for all purposes under the Code. Independent contractor status for purposes of employment taxes may be protected under section 530, but that classification may not be correct or appropriate for other tax purposes, such as liability for failure to offer health coverage to full-time employees under section 4980H, added by section 1513 of the PPACA (effective for calendar years beginning after December 31, 2013).

<sup>349</sup> See Catherine K. Ruckelshaus, "Labor's Wage War," *Fordham Urban Law Journal*, vol. 35, 2008, pp. 373-407.

<sup>350</sup> Under the common-law test, some factors may support employee status, while others may support independent contractor status. No guidance is provided for how to weigh any particular factor. In addition, some factors involve an examination of objective facts, while others involve an examination of subjective facts or an examination of a combination of objective and subjective facts. Because the determination of proper classification requires weighting the specific facts, reasonable people may differ as to the correct result given a certain set of facts. Thus, for example, even though a taxpayer in good faith determines that a worker is an independent contractor, an IRS agent may reach a different conclusion by weighing some of the relevant factors differently than the taxpayer. Similarly, a worker and a service recipient may reach different conclusions as to the proper classification of the worker.

necessary to counter balance the incentive for businesses to treat these workers as independent contractors and the lack of bargaining power of these workers being misclassified to demand employee treatment.<sup>351</sup>

### **Prospective versus retroactive application of reclassification determinations**

The proposal provides that a determination by the IRS that a worker should have been treated as an employee (rather than as an independent contractor) by the business or the payor may only be applied prospectively. Proponents of prospective application point out that the common-law test is a subjective facts and circumstances standard, and then argue that, if the business has a reasonable basis for concluding that workers are independent contractors, any liability resulting from a different determination by the IRS should only be prospective. They argue that this was the original reason for the enactment of section 530 to prevent the IRS from challenging a business and imposing penalties for the past. Opponents argue that prospective application could encourage businesses to “hide in the weeds” and hope that they are not identified through an audit. They point out that the economic benefit to businesses to take this position creates a significant motivation for a business to misclassify employees as independent contractors.

### **Consistent classification of workers for all purposes**

The proposal only applies for purposes of taxation, and by implication, for purposes of the Code. As indicated above, worker classification is relevant for purposes of numerous Federal laws and for State law purposes.

Some argue that the same definition of employee should apply for purposes of Federal tax law and Federal labor laws.<sup>352</sup> As long as treatment under a law is dependent on an individual’s status as an “employee,” absent a consistent definition, workers are unlikely to be able to independently determine their status for each purpose in order to demand the protection accorded them under Federal labor laws. Workers are more likely to be aware of their status for tax purposes. They know whether payroll taxes are being withheld from their paycheck or not. Thus, proponents of a single definition of employee for Federal law argue that the IRS is in the best position to administer and enforce proper worker classification. They argue that Federal agencies should be required to coordinate their interpretations of the law and enforcement with IRS.

---

<sup>351</sup> See *Nationwide Mutual Insurance Co. v. Darden*, 503 U.S. 318 (1992). However, some courts use a combination of the factors under the common-law test and economic realities test, reasoning that the common law allows all aspects of the working relationship to be considered. This approach generally arises in the context of Title VII cases. See, for example, *Wilde v. County of Kandiyohi*, 13 F. 3d 103 (8th Cir. 1994) and *Frankel v. Bally*, 987 F. 2d 86 (2nd Cir. 1993).

<sup>352</sup> Sharon Dietrich, Maurice Emsellem, and Catherine Ruckelshaus, “Work Reform: The Other Side of Welfare Reform: Our policymakers must face the reality that failures of employment law policies are a major reason for welfare reciprocity,” *Stanford Law and Policy Review*, vol. 9, Winter 1998, p. 60.

Opponents of consistent classification argue that there should not be one definition of employee but rather the definition should vary depending on the purpose for which the definition is being used under the law.<sup>353</sup> They argue that the definition should be customized to the specific purpose for which it is being used.

Alternatively, some commenters argue that some rights should not be conditioned on classification as an employee or independent contractor.<sup>354</sup> All workers of a particular type in a particular industry should have certain fundamental protections and rights, determined without regard to the worker's classification as employee or independent contractor. Others argue that a business should have only limited responsibility for workers not under its control or for workers that the employer does not have even the right to control.

### **Special rule in the proposal**

#### **Requiring withholding on payments to independent contractors**

The proposal imposes an income tax withholding requirement with respect to compensation paid pursuant to a contract between a service provider and a service recipient (or payor) described above equal to five percent of the compensation and only on compensation up to \$20,000 paid pursuant to the contract. Some argue that this mandated withholding is inconsistent with a legitimate service recipient and independent contractor relationship. They argue that inherent in that relationship is that the independent contractor is responsible for paying his or her own estimated taxes. However, withholding generally improves compliance.

### **Reporting requirements**

#### **Increasing the reporting threshold**

Proponents note that the proposal to increase the reporting threshold for filing the information returns used to report miscellaneous income, including nonemployee compensation together with the proposal to lower the *de minimis* exception for third party network transactions (discussed below) harmonizes the reporting rules for all types of payments (*e.g.*, cash or check or electronically through a third-party payment network) to independent contractors. Making the reporting threshold consistent across income types simplifies requirements and could increase tax compliance among taxpayers that are independent contractors.

---

<sup>353</sup> Marc Linder, "Employed or self-employed? The Role and Content of the Legal Distinction: Dependent and Independent Contractors in Recent U.S. Labor Law: an Ambiguous Dichotomy Rooted in Simulated Statutory Purposelessness," *Comparative Labor Law and Policy Journal*, vol. 21, Fall 1999, p. 187.

<sup>354</sup> Some circuits of the Court of Appeals have interpreted Title VII of the Civil Rights Act as protecting independent contractors (without regard to any reclassification as an employee) in certain circumstances. See for example, *Gomez v. Alexian Brothers Hospital*, 698 F. 2d 1019 (9th Cir. 1983), and *Doe v. St Joseph's Hospital*, 788 F. 2d 411 (7th Cir. 1986). See also G.J. Stillson MacDonnell, "Independent Contractor Status under Federal Labor and Employment Laws," p. 5.02[B] (discussing Court of Appeals cases that recognize Title VII as protecting employment opportunities of independent contractors and those cases that limit Title VII protection to employees).

Others may concede that the threshold should be changed from \$600 as this limit was enacted in 1954 but they may argue for decreasing or eliminating the threshold altogether rather than raising it to \$1,000. The threshold was originally enacted at a time when paper records increased recordkeeping and reporting burdens. However, these considerations are less compelling now given the ease of electronic reporting. With relatively low reporting burdens, it may even be possible to lower the threshold to \$10, the threshold for reporting dividends and interest. On the other hand, small businesses may continue to argue that reducing the threshold will result in a huge burden in terms of time spent and financial costs to comply.

#### Accelerating the due date

Accelerating the due date of information returns on reportable payment transactions to January 31, rather than February 28, improves the likelihood that the IRS has timely access to the data contained in the information returns received during the filing season and can use this data to detect errors.<sup>355</sup> Such access is critical in deterring fraudulent claims for refund, especially claims by identity thieves.

Proponents note that the nonfiling and underreporting of self-employment taxes account for 15 percent of the overall tax gap (the difference between what taxpayers owe and what they pay timely).<sup>356</sup> As online platform companies in the “gig” economy<sup>357</sup> continue to multiply and grow, the number of self-employed taxpayers grows. In many cases, the platform company may not withhold income and employment taxes from the service provider’s payments. Furthermore, many self-employed individuals may not understand the tax obligations of their activities. As a result, it may be necessary to strengthen and improve self-employment tax compliance efforts, for example, through third-party information reporting which may encourage individuals to file accurate returns.<sup>358</sup> An acceleration of the filing date for these information reports to the IRS allows more effective use of these data by the IRS.

Proponents also note that the gap between the time that information reports by payors are required to be provided to individuals (no later than January 31 following the close of the calendar year<sup>359</sup>), and the extra month or two that the payor is required to submit the related information return

---

<sup>355</sup> The individual income tax filing season is the period beginning in January when the IRS first accepts for filing income tax returns for the preceding calendar year and ending April 15, the due date (absent an extension) for individual income tax returns. In 2019, the filing season opened January 28, 2019, according to a news release issued December 2018. See IR-2019-07, available at <https://www.irs.gov/newsroom/irs-kicks-off-2019-tax-filing-season-as-tax-agency-reopens-use-irsgov-to-avoid-phone-delays>.

<sup>356</sup> Inspector General for Tax Administration, Department of the Treasury, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (TIGTA-2019-30-016), February 14, 2019, p. 1 available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf>.

<sup>357</sup> *Ibid.*

<sup>358</sup> H.R. Rep. No. 110-728, p. 35 (2008).

<sup>359</sup> Sec. 6050W(f).

to the IRS is unnecessarily long. The present law disparity between the due date for submitting these information returns on paper and filing electronically may contribute to the problem.

Opponents of the proposal to require earlier filing dates for these information returns may point to the need for a reasonable period of time between submission of information to a participating payee and filing with a government agency, during which the payee may identify errors and inform the payment settlement entity payor so that these errors may be corrected.

#### Reducing the *de minimis* exception for reports of third party network transactions

Proponents argue that reducing the *de minimis* exception for reporting of aggregate third party network transactions to a participating payee is necessary because taxpayers who do not receive a tax information return from the online platform company may misunderstand or be unaware of their income tax and self-employment tax liabilities.<sup>360</sup> Because information returns are not required unless taxpayers earn at least \$20,000 and engage in at least 200 transactions annually, many taxpayers who earn income and owe tax in the “gig” economy do not receive information forms. In addition, their income may not be reported to the IRS. As a result, many self-employed workers in the “gig” economy may not comply with their tax obligations. The IRS’s tax gap analyses indicates that there is generally higher compliance when amounts are subject to information reporting.<sup>361</sup>

Proponents also argue that reducing the *de minimis* exception is desirable because income that meets the exception may still be subject to tax, but is not reported anywhere else. The IRS instructions to Form 1099-K, *Payment Card and Third Party Network Transactions*, provide that third party settlement organizations are not required to issue a Form 1099-MISC, Miscellaneous Income (the information return for certain payments made to payees in the course of the payor’s trade or business) when the payor makes payments to a payee between \$600 and \$20,000.<sup>362</sup> It is not clear that this result was intended. Lowering the *de minimis* exception would help eliminate this reporting gap.

---

<sup>360</sup> Inspector General for Tax Administration, Department of the Treasury, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (TIGTA 2019-30-016), February 14, 2019, pp. 3-4 citing Testimony of Nina E. Olson, National Taxpayer Advocate, House Committee on Small Business Hearing on “The Sharing Economy: A Taxing Experience for New Entrepreneurs, Part II,” May 26, 2016, available at <https://www.govinfo.gov/content/pkg/CHRG-114hhrg20276/html/CHRG-114hhrg20276.htm> (“The service provider may not have been aware of the consequences of being classified as a nonemployee and may not have set aside money for self-employment tax or have made quarterly estimated payments”).

<sup>361</sup> Inspector General for Tax Administration, Department of the Treasury, *Expansion of the Gig Economy Warrants Focus on Improving Self-Employment Tax Compliance* (TIGTA-2019-30-016), February 14, 2019, p. 3, available at <https://www.treasury.gov/tigta/auditreports/2019reports/201930016fr.pdf>.

<sup>362</sup> The IRS instructions to Form 1099-K provide that “Payments made by payment card or through a third party payment network after December 31, 2010, that otherwise would be reportable under sections 6041 (payments of \$600 or more) or 6041A(a) (payments of remuneration for services and certain direct sales) and 6050W are reported under section 6050W and not section 6041 or 6041A. For purposes of determining whether payments are subject to reporting under section 6050W, rather than section 6041 or 6041A, the *de minimis* threshold, discussed later under Box 1a, is disregarded.”

Proponents may further argue that lowering the threshold helps align the Federal rules with certain States that have passed legislation requiring third party settlement organizations to file information returns with the IRS and furnish these statements to the taxpayer at a lower income threshold. For example, seven jurisdictions require the Form 1099-K to be filed at significantly lower thresholds than the IRS and with no transaction limits. Those thresholds are: (i) \$2,500 or more for Arkansas;<sup>363</sup> (ii) \$1,200 or more for Missouri;<sup>364</sup> (iii) \$1,000 or more for New Jersey;<sup>365</sup> and (iv) \$600 or more for the District of Columbia,<sup>366</sup> Massachusetts,<sup>367</sup> and Vermont,<sup>368</sup> and (v) more than \$600 for Mississippi.<sup>369</sup>

On the other hand, opponents may argue that lowering the threshold goes against efforts to minimize taxpayer burden. This change will result in a burden on small businesses — both in terms in time spent and financial costs to comply. Unlike larger companies, small businesses often do not have the resources to hire teams of tax lawyers or accountants to guide them. As such, the incremental burden of filing additional forms may be significant.

---

<sup>363</sup> Ark. Code Ann. sec. 26-51-811.

<sup>364</sup> Mo. Rev. Stat. sec. 143.591.

<sup>365</sup> N.J. Admin. Code sec. 18:35-8.1.

<sup>366</sup> D.C. Mun. Regs. tit. 9, sec. 111.1.

<sup>367</sup> Mass. Dept. of Revenue, Technical Information Release 17-11: New Massachusetts Reporting Requirements for Third Party Settlement Organizations, November 29, 2017 (third party settlement organization must report payments that are \$600 or greater, effective for all amounts paid in settlement to payees beginning with the 2017 calendar year).

<sup>368</sup> Vt. Stat. Ann. Tit. 32, sec. 5862d.

<sup>369</sup> Miss. Code Ann. sec. 27-7-39.

**F. Require a Social Security Number that is Valid for Work in Order  
to Claim Child Tax Credit, Earned Income Tax Credit,  
and/or Credit for Other Dependents**

**Present Law**

An individual taxpayer may be eligible to claim an earned income tax credit (“EITC”), a child tax credit (“CTC”) for each qualifying child of the taxpayer, and a credit for other dependents (“ODTC”) for each dependent of the taxpayer that is not a qualifying child of the taxpayer for purposes of the CTC. Each credit is subject to different identification requirements.

**Earned income tax credit**

The EITC generally equals a specified percentage of earned income up to a maximum dollar amount.<sup>370</sup> The amount of the EITC is based on the number of qualifying children in the taxpayer’s family, filing status, adjusted gross income (“AGI”), and earned income.

An individual taxpayer is eligible to claim the EITC if the taxpayer has a qualifying child for the tax year. Alternately, if the taxpayer does not have a qualifying child, he or she is eligible to claim the EITC if the taxpayer’s principal place of abode for more than one-half of the tax year is in the United States, the taxpayer is older than 24 and younger than 65, and the taxpayer is not a dependent of another taxpayer.

For purposes of the EITC, a qualifying child is an individual who is the taxpayer’s son, daughter, stepson, stepdaughter, brother, sister, stepbrother, stepsister, or a descendant of any of the preceding. The individual must either be younger than 19 or, if the individual is a student, younger than 24. The individual must share the same principal place of abode as the taxpayer for more than one-half of the tax year and such principal place of abode must be in the United States. The individual may not file a joint return with a spouse.

The maximum dollar amount of EITC applies over a certain income range and then diminishes to zero over a specified phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the beginning of the phaseout range, the maximum EITC amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the beginning of the phaseout range. For taxpayers with earned income (or AGI, if greater) in excess of the end of the phaseout range, no credit is allowed.

The specified percentage, maximum dollar amount, and phaseout rate and range vary with filing status and number of qualifying children. Earned income is defined as the sum of wages, salaries, tips, and other employee compensation, to the extent includible in gross income, plus net self-employment earnings. An individual is not eligible for the EITC if the aggregate amount of certain investment income of the taxpayer for the tax year exceeds a threshold, indexed for inflation.

---

<sup>370</sup> Sec. 32.

Taxpayers who are nonresident aliens for any portion of the tax year are not eligible to claim the EITC unless an election under section 6013(g) or (h) (relating to taxpayers who are married to an individual who is either a citizen or resident of the United States at year end) is in effect for the tax year.<sup>371</sup>

The EITC is a refundable credit, meaning that if the amount of the credit exceeds the taxpayer's Federal income tax liability, the excess is treated as an overpayment of tax payable to the taxpayer.

### **Child tax credit**

The CTC is a credit of a fixed dollar amount for each qualifying child of the taxpayer.<sup>372</sup>

Qualifying child has the same definition as for purposes of the EITC except that, for purposes of the CTC, the individual must be younger than 17, and the individual may not have provided over one half of his or her own support for the tax year. As with the EITC, the individual must share the same principal place of abode as the taxpayer for more than one-half of the tax year, but such principal place of abode does not need to be in the United States. However, the individual must be a citizen, national, or resident of the United States.

The aggregate CTC is phased out for taxpayers with income over certain threshold amounts. Specifically, the aggregate amount of credit is reduced by \$50 for each \$1,000 (or fraction thereof) of modified adjusted gross income ("modified AGI") over a specified threshold.<sup>373</sup>

To the extent the amount of the CTC exceeds the taxpayer's tax liability, the taxpayer is eligible for a refundable credit (the "additional child tax credit") equal to 15 percent of earned income in excess of a threshold amount. A taxpayer with three or more qualifying children may take the additional child tax credit in the amount by which the taxpayer's Social Security taxes exceed the taxpayer's credit under the EITC if that amount is greater than the additional child tax credit based on the taxpayer's earned income.

Earned income has the same definition as for purposes of the EITC, except that, for purposes of the CTC, earned income is limited to income that is taken into account in computing taxable income.

For tax years beginning prior to January 1, 2018, the amount of the CTC is \$1,000 for each qualifying child of the taxpayer, the maximum additional child tax credit is \$1,000 for each qualifying child of the taxpayer, and the threshold amount under the earned income formula is

---

<sup>371</sup> In addition, taxpayers who claim the benefits of section 911 (relating to the income exclusion election available to U.S. citizens or resident aliens living abroad) are not eligible to claim the EITC.

<sup>372</sup> Sec. 24.

<sup>373</sup> For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories. Secs. 911, 931, 933.

\$3,000. The modified AGI threshold amount is \$75,000 for single individuals or heads of households, \$110,000 for married individuals filing joint returns, and \$55,000 for married individuals filing separate returns.

The 2017 Tax Act temporarily modified the CTC for tax years beginning after December 31, 2017 and prior to January 1, 2026.<sup>374</sup> For such years, the amount of the CTC is \$2,000 for each qualifying child of the taxpayer, the maximum additional child tax credit is \$1,400 for each qualifying child of the taxpayer (indexed for inflation up to \$2,000), and the threshold amount under the earned income formula is \$2,500. The modified AGI threshold is \$400,000 for married individuals filing joint returns and \$200,000 for all other taxpayers.

### **Other dependent tax credit**

For tax years beginning prior to January 1, 2018 and after December 31, 2025, a taxpayer may claim a deduction for personal exemptions for each dependent, *i.e.*, each qualifying child or qualifying relative of the taxpayer. The 2017 Tax Act temporarily suspended the deduction for personal exemptions and added the ODTTC, available for tax years beginning after December 31, 2017 and before January 1, 2026.<sup>375</sup>

The ODTTC is a credit of \$500 for each dependent of the taxpayer other than a qualifying child for purposes of the CTC. Thus, an eligible dependent generally is either (i) a qualifying child age 17 or 18 or a student under the age of 24, or (ii) a qualifying relative. A qualifying relative is an individual with a specified relationship to the taxpayer or an individual who has the same principal place of abode as the taxpayer and is a member of the taxpayer's household. The individual's gross income must be less than an exemption amount,<sup>376</sup> the taxpayer must provide over one-half of the individual's support for the tax year, and the individual must be a citizen, national, or resident of the United States. Additionally, a qualifying child that is not taken into account for purposes of the CTC due to the CTC Social Security number ("SSN") requirement, discussed more below, may qualify as a dependent for purposes of the ODTTC.

The ODTTC, unlike the EITC and CTC, is nonrefundable.

### **Taxpayer identification number, Social Security number, and individual taxpayer identification number**

A taxpayer is required to include a taxpayer identification number ("TIN") when filing a U.S. tax return. Generally, an individual taxpayer's TIN is his or her SSN.<sup>377</sup>

---

<sup>374</sup> Sec. 24(h). This provision is also discussed in part I of this document.

<sup>375</sup> Sec. 24(h)(4). This provision is also discussed in part I of this document.

<sup>376</sup> The applicable amount in 2019 is \$4,200. See IRS Notice 2018-70, 2018-38 I.R.B. 441; Rev. Proc. 2018-57, 2018-49 I.R.B. 827.

<sup>377</sup> Sec. 6109(a); Treas. Reg. sec. 301.6109-1(a)(1)(ii)(A).

Noncitizens may be eligible to receive SSNs. The Social Security Administration (“SSA”) is authorized to issue an SSN to a noncitizen for certain purposes including (1) work authorization or (2) claiming a benefit financed in whole or in part from Federal funds.<sup>378</sup> Prior to 2003, the SSA issued SSNs to noncitizens for valid nonwork and non-benefits reasons such as to obtain drivers’ licenses or to open bank accounts.<sup>379</sup> While the SSA no longer issues SSNs for such purposes,<sup>380</sup> it did not rescind previously issued SSNs.

An individual who has a U.S. tax filing obligation but who is not eligible to receive an SSN must apply to the IRS for an individual taxpayer identification number (“ITIN”) for use in connection with the individual’s tax filing obligation.<sup>381</sup> An individual who is eligible to receive an SSN may not apply for an ITIN.<sup>382</sup> An ITIN does not provide eligibility to work in the United States or allow the ITIN holder to claim Social Security benefits.

ITINs issued after December 31, 2012 expire if not used on a Federal income tax return for a period of three consecutive taxable years.<sup>383</sup> For ITINs issued prior to 2013, Congress established a schedule whereby all such ITINs would be phased out of circulation, providing that ITINs would be invalid as of the applicable date, in accordance with the following schedule:<sup>384</sup>

<b>Year ITIN Issued</b>	<b>Applicable Date</b>
Pre-2008	January 1, 2017
2008	January 1, 2018
2009 or 2010	January 1, 2019
2011 or 2012	January 1, 2020

---

<sup>378</sup> See Section 205(c)(2)(B)(i)(I), (II) of the Social Security Act, codified as 42 U.S.C. sec. 405(c)(2)(B)(i)(I), (II). The Social Security Administration is also authorized to issue SSNs to individuals who could have been but were not assigned SSNs for either of these purposes, if certain other conditions are met. Section 205(c)(2)(B)(i)(III) of the Social Security Act, codified as 42 U.S.C. sec. 405(c)(2)(B)(i)(III).

<sup>379</sup> See 20 C.F.R. sec. 422.104(a)(3) (2002).

<sup>380</sup> See 68 F.R. 55304, amending 20 C.F.R. sec. 422.104.

<sup>381</sup> Treas. Reg. Sec. 301.6109-1(a)(1)(ii)(B), (d)(3).

<sup>382</sup> Treas. Reg. Sec. 301.6109-1(d)(3)(ii).

<sup>383</sup> Sec. 6109(i)(3)(A).

<sup>384</sup> Sec. 6109(i)(3)(B).

## **Earned income tax credit, child tax credit, and other dependent tax credit identification requirements**

The EITC imposes specific identification requirement on the taxpayer, the taxpayer's spouse (if applicable), and the qualifying children of the taxpayer (if applicable). In order to claim the EITC, a taxpayer must include on his or her return the taxpayer's SSN.<sup>385</sup> If the taxpayer is married, the taxpayer must also include the taxpayer's spouse's SSN. A taxpayer with qualifying children must also include on his or her return the SSN of each qualifying child in order for such child to be taken into account for purposes of the EITC.<sup>386</sup> If a taxpayer with qualifying children does not include the SSN of at least one qualifying child, the taxpayer is ineligible to claim the EITC at all.<sup>387</sup> For purposes of these requirements, an SSN that was issued for the purposes of claiming a benefit financed from Federal funds is invalid. SSNs issued for purposes of work authorization or SSNs that, under prior Social Security Act regulations, were issued for valid nonwork purposes such as to obtain drivers' licenses or to open bank accounts, are valid.

In order to claim the CTC, neither the taxpayer nor the taxpayer's spouse (if applicable) are subject to an SSN requirement, although they are subject to the general requirement that taxpayers include TINs on their return. The identification requirement imposed on qualifying children is temporarily changed by the 2017 Tax Act. For tax years beginning prior to January 1, 2018 or after December 31, 2025, the taxpayer must include a TIN issued on or before the due date of the return for each qualifying child in order for such child to be taken into account for purposes of the CTC.<sup>388</sup> For tax years beginning after December 31, 2017 and before January 1, 2026, the taxpayer must include a valid SSN issued before the due date of the return for each qualifying child in order for such child to be taken into account for purposes of the CTC.<sup>389</sup> For purposes of the SSN requirement, only SSNs that are issued to (1) citizens or (2) noncitizens for work authorization purposes are valid. As mentioned above, a qualifying child that is not taken into account for purposes of the CTC due to the SSN requirement is considered to be a dependent for purposes of the ODTTC.

In order to claim the ODTTC, neither the taxpayer nor the taxpayer's spouse (if applicable) are subject to an SSN requirement, although they are subject to the general requirement that taxpayers include TINs on their return. Dependents are subject to an identification requirement. The taxpayer must also include a TIN for each dependent in order for such dependent to be taken

---

<sup>385</sup> Sec. 32(c)(1)(E), (m).

<sup>386</sup> Sec. 32(c)(3)(D), (m).

<sup>387</sup> Sec. 32(c)(3)(F), (m).

<sup>388</sup> Sec. 24(e)(1).

<sup>389</sup> Sec. 24(h)(7).

into account for purposes of the ODTC.<sup>390</sup> This is parallel to the requirement, for tax years beginning prior to January 1, 2018 or after December 31, 2025, that requires a taxpayer to include a TIN for each dependent in order for such dependent to be taken into account for purposes of the deduction for purposes of the deduction for personal exemptions.<sup>391</sup>

### **Description of Proposal**

The proposal imposes an SSN requirement on the taxpayer, the taxpayer’s spouse (if applicable), and the taxpayer’s qualifying children or dependents (as applicable) for purposes of the EITC, CTC, and ODTC. For purposes of this requirement, the SSN must be valid for work purposes.<sup>392</sup>

Individuals who do not have a valid-for-work SSN include individuals who do not have SSNs but only ITINS and individuals who, under prior Social Security Act regulations, were issued an SSN for valid nonwork or non-benefits purposes, such as to obtain drivers’ licenses or to open bank accounts.

The following table summarizes the present law SSN requirements and the proposed changes:

	<b>Requirement for Taxpayer and Taxpayer’s spouse (if applicable)</b>		<b>Requirement for qualifying child or dependent (as applicable)</b>	
	Present Law	Proposal	Present Law	Proposal
EITC	SSN <sup>1</sup>	SSN <sup>2</sup>	SSN <sup>1</sup>	SSN <sup>2</sup>
CTC <sup>3</sup>	TIN	SSN <sup>2</sup>	TIN	SSN <sup>2</sup>
CTC <sup>4</sup>	TIN	SSN <sup>2</sup>	SSN <sup>2</sup>	SSN <sup>2</sup>
ODTC	TIN	SSN <sup>2</sup>	TIN	SSN <sup>2</sup>

**Notes:**

<sup>1</sup> SSN except an SSN issued for the purposes of claiming a benefit financed from Federal funds.

<sup>2</sup> SSN that is valid for work authorization purposes.

<sup>3</sup> CTC for tax years beginning prior to January 1, 2018 and after December 31, 2025.

<sup>4</sup> CTC for tax years beginning after December 31, 2017 and prior of January 1, 2026.

**Effective date.**—This proposal is generally effective for taxable years beginning after December 31, 2019.

---

<sup>390</sup> A technical correction may be necessary to achieve this result. See Internal Revenue Service Publication 972, p. 4. See also sec. 24(e)(1).

<sup>391</sup> Sec. 151(e).

<sup>392</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item IV.F.

## Analysis

### In general

The proposal imposes a valid-for-work SSN requirement on the taxpayer, the taxpayer's spouse (if applicable), and the taxpayer's qualifying children and dependents (as applicable) for purposes of the EITC, CTC, and ODTC. Proponents of SSN requirements may rely on two independent rationales in support of such a requirement for purposes of these credits, a work authorization rationale and an anti-fraud rationale.

#### Work authorization rationale

Proponents may argue that only taxpayers with valid work authorization should be entitled to these credits. As support for this, they may point out that the EITC has an SSN requirement under present law. The legislative history of this requirement, which was enacted in 1996,<sup>393</sup> states that “[t]he Congress did not believe that individuals who are not authorized to work in the United States should be able to claim the credit.”<sup>394</sup> In addition, the EITC and the additional child tax credit component of the CTC are based on earned income. Proponents may argue that a taxpayer should not be entitled to the benefit of these credits if that income was earned without valid work authorization. This earned income argument does not apply with respect to the ODTC, which does not have an earned income component and which, under current law, acts as a substitute for the CTC for taxpayers with qualifying children who do not satisfy the SSN requirement.

Relatedly, proponents may also argue that the EITC, CTC, and ODTC are in essence Federal welfare programs, and that taxpayers without SSNs may be undocumented immigrants and should not be entitled to Federal welfare programs.<sup>395</sup>

Opponents of the proposal may point to the fact that individuals who are working in the United States without authorization nonetheless have a tax filing obligation. A significant number of unauthorized workers pay Social Security taxes but may never receive Social Security

---

<sup>393</sup> Personal Responsibility and Work Opportunity Reconciliation Act of 1996, Pub. L. No. 104-193, sec. 451(b).

<sup>394</sup> Report to accompany H.R. 3734, Welfare and Medicaid Reform Act of 1986, H. R. Rep. 104-651, June 27, 1996, p.1457.

<sup>395</sup> As a general matter, the Supplemental Nutrition Assistance Program, nonemergency Medicaid, Supplemental Security Income (“SSI”), and Temporary Assistance for Needy Families (“TANF”) are not accessible to undocumented immigrants. However, undocumented immigrants are eligible for emergency Medicaid if they are otherwise eligible for their State’s Medicaid program, public health programs providing immunizations and/or treatment of communicable disease symptoms, school breakfast and lunch programs, and every State has opted to provide access to the Special Supplemental Nutrition Program for Women, Infants and Children (“WIC”). Undocumented immigrants are also allowed certain other short-term noncash emergency disaster assistance and other in-kind services necessary to protect life and safety.

benefits,<sup>396</sup> creating an inequity between them and otherwise similarly situated workers. Under present law, unauthorized workers are ineligible to claim the EITC and may be unable to claim the CTC, depending on whether they have qualifying children with valid SSNs, which increases this horizontal equity. The denial of the CTC and ODTTC would exacerbate it further.

Furthermore, opponents may argue that denying unauthorized workers CTC and ODTTC could cause such individuals to owe additional amounts to the Federal government upon filing tax returns. This may deter such individuals from meeting their tax filing obligations, especially if they did not have the cash to pay the resulting tax liability. Because, when applying for an immigration benefit such as naturalization or defending against deportation, filing taxes may be a means by which an individual can demonstrate “good moral character,” opponents of the proposal may argue that the Congress should not further deter those who have worked illegally from filing.

#### Anti-fraud rationale

Proponents of the proposal may also point to evidence of the use of ITINs on fraudulent tax returns as a reason to impose an SSN requirement. For instance, the Treasury Inspector General for Tax Administration (“TIGTA”), in its review of 2011 tax filings, identified over 141,000 individual tax returns that had the characteristics of IRS-confirmed identity theft tax returns. TIGTA concluded that these returns resulted in approximately \$385 million in potentially fraudulent tax refunds.<sup>397</sup> By preventing the CTC and ODTTC from being claimed for a taxpayer, qualifying child, or dependent without an SSN, Congress would significantly reduce the value of a fraudulently obtained ITIN.

While the EITC currently has an SSN requirement, modifying the requirement may also help Treasury and the IRS determine which taxpayers have SSNs that are valid for purposes of that credit.

Opponents may argue that, while fraud concerns may provide a rationale for imposing an SSN requirement, the rationale does not support requiring only SSNs that are valid for work authorization purposes. Additionally, opponents may point out that under present law, the CTC has an SSN requirement for qualifying children but not for the taxpayer or the taxpayer’s spouse. This partial SSN requirement may strike an appropriate balance between combatting fraud and allowing taxpayers to take advantage of the credit.

Additionally, opponents may argue that there have been significant programmatic and legislative changes regarding the issuance of ITINs since TIGTA’s review of the 2011 tax filings, rendering ITINs less susceptible to fraud. Congress enacted changes to the ITIN

---

<sup>396</sup> Francine J. Lipman, “The ‘ILLEGAL’ Tax,” *Connecticut Public Interest Law Journal*, vol. 11, 2012, pp. 93-132.

<sup>397</sup> Inspector General For Tax Administration, Department of the Treasury, *Detection Has Improved; However, Identity Theft Continues To Result In Billions Of Dollars In Potentially Fraudulent Tax Refunds* (TIGTA 2013-40-122), September 20, 2013. Available at <https://www.treasury.gov/tigta/auditreports/2013reports/201340122fr.pdf>.

program, designed to reduce the number of outstanding fraudulent ITINs and to provide for changes in ITIN issuance procedures.<sup>398</sup> Among these changes was an expiration period for unused ITINs, as described above. Opponents of the proposal may thus point to the enactment of these legislative changes as obviating any need to limit further the use of ITINs as a fraud prevention method, as ITINs are now being issued with a more stringent application procedure, and older ITINs are being invalidated.

### **Earned income tax credit proposal**

In addition to the arguments set forth above, proponents of the proposal may argue that the proposal is consistent with the current EITC SSN requirement, which prevents taxpayers with an SSN issued for the purposes of claiming a benefit financed from Federal funds from claiming the EITC.

Opponents may argue that it is unfair to change the eligibility requirements such that the group of taxpayers who have valid nonwork and non-Federal benefits SSNs, who have long qualified for the EITC, no longer qualify. The number of persons with SSNs affected by this change has gradually declined since 2003, because many individuals who have received such SSNs are no longer able to be claimed as qualifying children on their parents' returns, and the number of working taxpayers with such SSNs declines over time. Opponents may therefore also point out that the cost of continuing to provide the EITC to persons with SSNs affected by this change is declining over time.

### **Child tax credit proposal**

In addition to the arguments set forth above, proponents may point to the fact that the EITC, the only other refundable tax credit in the Code that is calculated based on a taxpayer's earned income, has an SSN requirement. By requiring an SSN for the CTC, Congress would create parity with the EITC.

Opponents of the proposal may point out that, while the additional child tax credit component of the CTC is based on earned income, the CTC, as a general matter for those with positive tax liability, is not. A taxpayer is generally eligible for the CTC without regard to the nature of the taxpayer's income, provided he or she meets the requirements for claiming the credit. Given that there is no general requirement of having earned income to claim the CTC, opponents may challenge the application of the SSN requirement to the child tax credit writ-large (rather than just the additional portion of the child tax credit). Other adjustments to tax liability not based on earned income, such as the standard deduction and the deduction for home mortgage interest, do not require the taxpayer to have an SSN. In that sense, requiring an SSN in the case of the nonrefundable portion of the CTC may be incongruous with other deductions in the Code.

Additionally, opponents of the proposal may question why the proposal requires both spouses to have an SSN in order to claim the CTC. For instance, it is possible that one spouse may have work authorization (and accordingly, a valid-for-work SSN), while the other spouse

---

<sup>398</sup> Consolidated Appropriations Act, 2016, Pub. L. No. 114-113, Div. Q, sec. 203.

may simply be accompanying that spouse (and may possibly not be eligible for work authorization, although lawfully present). Alternatively, one spouse may have work authorization (and a valid-for-work SSN) and may reside in the United States with one or more children, while the other spouse may be resident abroad. The U.S. taxpayer must file as a married taxpayer; this taxpayer would not be able to claim the CTC unless the nonresident spouse were issued an SSN.

### **Other dependent tax credit proposal**

In addition to the argument set forth above, opponents may point out that the deduction for personal exemptions, temporarily suspended until 2026, does not have an SSN requirement but only requires taxpayers to provide a valid TIN for each dependent. If the ODTC is viewed as a substitute for this deduction, it would be inconsistent to impose an SSN requirement for purposes of the ODTC.

Additionally, opponents of the proposal may point out that the ODTC, unlike the EITC and CTC, is not based on earned income. Therefore, the argument that a taxpayer should not be entitled to tax credits if the taxpayer earned income without valid work authorization is not applicable with respect to this credit.

Finally, opponents may point out that under present law, a qualifying child that is not taken into account for purposes of the CTC due to the SSN requirement is considered to be a dependent for purposes of the ODTC. This reflects an intent on the part of Congress to allow the ODTC for taxpayers unable to claim the CTC. Imposing an SSN requirement with respect to the ODTC is at odds with this purpose.

## PART V – ENERGY

### A. Repeal the Qualified Plug-In Electric Drive Motor Vehicle Credit

#### Present Law

A credit is available for new four-wheeled vehicles (excluding low-speed vehicles and vehicles weighing 14,000 pounds or more) propelled by a battery with at least 4 kilowatt-hours of electricity that can be charged from an external source.<sup>399</sup> The base credit is \$2,500 plus \$417 for each kilowatt-hour of additional battery capacity in excess of 4 kilowatt-hours (for a maximum credit of \$7,500). Qualified vehicles are subject to a 200,000 vehicle-per-manufacturer limitation. Once the limitation has been reached the credit is phased down over four calendar quarters.

#### Description of Proposal

The proposal repeals the credit for plug-in electric drive motor vehicles.<sup>400</sup>

Effective date.—The proposal is effective for vehicles placed in service after December 31, 2019.

#### Analysis

Generally, policymakers offer two broad rationales for intervention in the energy markets and for using tax policy to help effectuate these policy goals: to promote domestic energy independence and to reduce pollution.<sup>401</sup>

The credit for plug-in electric drive motor vehicles incentivizes the use of plug-in electric drive motor vehicles over other motor vehicles. To the extent that the transportation sector is more dependent on energy imports (crude oil for motor fuel) than the electricity generation sector, the use of plug-in electric drive motor vehicles may promote domestic energy use. Depending on the type of fuel used to generate electricity for these vehicles, fossil-fuel emissions are reduced to varying degrees by use of plug-in electric drive motor vehicles in place of fossil-fuel powered motor vehicles.

However, a tax credit for plug-in electric drive motor vehicles may not be the most efficient way to achieve either main policy goal. There may be more direct ways to encourage domestic energy independence, and economists generally agree that the most efficient method to

---

<sup>399</sup> Sec. 30D.

<sup>400</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item V.A.

<sup>401</sup> For a recent discussion of the rationale behind energy tax provisions see Joint Committee on Taxation, *Federal Tax Provisions Expired in 2017 and 2018 and Expiring in 2019* (JCX-8-19), March 8, 2019.

reduce pollution emissions is to impose a price on those emissions (through a tax or other mechanism) rather than to impose narrowly targeted subsidies or regulations.

## **B. Repeal Exclusion of Utility Conservation Subsidies**

### **Present Law**

An exclusion from gross income is provided for the value of any subsidy provided by a public utility to a customer for the purchase or installation of any energy conservation measure, meaning any installation or modification primarily designed to reduce consumption of electricity or natural gas or to improve the management of energy demand with respect to a dwelling unit.<sup>402</sup>

No deduction or credit is allowed for any expenditure to the extent of the exclusion taken for any subsidy received, and the adjusted basis of the property is reduced by the amount excluded.

A “public utility” means a person engaged in the sale of electricity or natural gas to residential, commercial, or industrial customers for use by such customers. For purposes of this definition, the term “person” includes the Federal Government, a State or local government, or any political subdivision or instrumentality thereof. The exclusion does not apply with respect to any payment to or from a qualified cogeneration facility or qualifying small power production facility pursuant to section 210 of the Public Utility Regulatory Policy Act of 1978.

### **Description of Proposal**

The proposal repeals the exclusion from income of conservation subsidies paid by utilities to their non-business customers.<sup>403</sup>

Effective date.—The proposal is effective for subsidies paid on or after January 1, 2020.

### **Analysis**

Generally, policymakers offer two broad rationales for intervention in the energy markets and for using tax policy to help effectuate these policy goals: to promote domestic energy independence and to reduce pollution.<sup>404</sup>

The exclusion of utility conservation subsidies incentivizes utilities to provide subsidies to public utility customers to reduce energy consumption through the purchase or installation of energy conservation measures. Generally encouraging energy conservation may reduce the

---

<sup>402</sup> Sec. 136.

<sup>403</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item V.B.

<sup>404</sup> For a recent discussion of the rationale behind energy tax provisions see Joint Committee on Taxation, *Federal Tax Provisions Expired in 2017 and 2018 and Expiring in 2019* (JCX-8-19), March 8, 2019.

amount of residential energy used and thus may reduce the amount of energy imports. In addition, reductions in residential energy use may also reduce the amount of fossil-fuel pollution.

However, the exclusion of utility conservation subsidies may not be the most efficient way to achieve either main policy goal. There may be more direct ways to encourage energy conservation to move towards domestic energy independence, and economists generally agree that the most efficient method to reduce pollution emissions is to impose a price on those emissions (through a tax or other mechanism) rather than to impose narrowly targeted subsidies or regulations.

## C. Repeal Accelerated Depreciation for Renewable Energy Property

### Present Law

#### In general

Certain renewable and alternative energy property is allowed five-year accelerated depreciation.<sup>405</sup> This property includes wind power, solar power, and geothermal power property. It also includes, for qualified property the construction of which begins before January 1, 2022, fiber optic solar, fuel cells, microturbines, geothermal heat pumps, and combined heat and power system property.<sup>406</sup> Such property is generally allowed to be currently deducted using bonus depreciation through December 31, 2022.<sup>407</sup>

#### Qualified property

Qualified solar or wind property is property that uses solar or wind energy to generate electricity, to heat or cool a structure, or to provide solar process heat. However, such property cannot be used to generate energy for the purpose of heating a swimming pool. Qualified geothermal property is property that is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage.

Fiber optic solar property is equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure.

A qualified fuel cell power plant is an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half kilowatt.

A qualified stationary microturbine power plant is an integrated system composed of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency, and power factors. Such system must have an electricity-only generation efficiency of not less than 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

---

<sup>405</sup> Sec. 168(e)(3)(B)(vi). Other than property owned by rate-regulated utilities, such property is generally allowed to be currently deducted using bonus depreciation through December 31, 2022. Sec. 168(k).

<sup>406</sup> *Ibid.* See also section 48(a)(3).

<sup>407</sup> Sec. 168(k).

Qualified geothermal heat pump property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

Combined heat and power system property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of not more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. Combined heat and power system property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

### **Description of Proposal**

The proposal repeals the five-year accelerated depreciation available to renewable and alternative energy property.<sup>408</sup>

Effective date.—The proposal is effective for property placed in service on or after January 1, 2020.

### **Analysis**

Generally, policymakers offer two broad rationales for intervention in the energy markets and for using tax policy to help effectuate these policy goals: to promote domestic energy independence and to reduce pollution.<sup>409</sup>

Generally the five-year accelerated depreciation available to renewable and alternative energy property may encourage investment in renewable energy production or more efficient fossil-fuel energy production and thus help reduce the amount of energy imports. In addition, energy production from renewable sources or more efficient energy production from fossil-fuel sources may also reduce the amount of fossil-fuel pollution. However, because such property is generally allowed to be currently deducted using bonus depreciation through December 31, 2022,<sup>410</sup> this provision has no incentive effect during this time period.

---

<sup>408</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item V.C.

<sup>409</sup> For a recent discussion of the rationale behind energy tax provisions see Joint Committee on Taxation, *Federal Tax Provisions Expired in 2017 and 2018 and Expiring in 2019* (JCX-8-19), March 8, 2019.

<sup>410</sup> Sec. 168(k).

Additionally, the energy investment credit may not be the most efficient way to achieve either main policy goal. There may be more direct ways to encourage domestic energy independence, and economists generally agree that the most efficient method to reduce pollution emissions is to impose a price on those emissions (through a tax or other mechanism) rather than to impose narrowly targeted subsidies or regulations.

## **D. Repeal Energy Investment Credit**

### **Present Law**

#### **In general**

A permanent nonrefundable 10-percent business energy credit<sup>411</sup> is allowed for the cost of new property that is equipment that either (1) uses solar energy to generate electricity, to heat or cool a structure, or to provide solar process heat or (2) is used to produce, distribute, or use energy derived from a geothermal deposit, but only, in the case of electricity generated by geothermal power, up to the electric transmission stage. Property used to generate energy for the purposes of heating a swimming pool is not eligible solar energy property.

In addition to the permanent credit, a number of energy technologies are entitled to the energy credit at rates of 10 percent or 30 percent, depending on the technology. These credits are subject to rate phasedown and sunset limitations. In addition, the credit rate for solar energy property has been temporarily increased to 30 percent but is also subject to a rate phasedown rule.

The energy credit is a component of the general business credit.<sup>412</sup> The taxpayer's basis in the property with respect to which the credit is claimed is reduced by one-half of the amount of the credit claimed.<sup>413</sup> For projects whose construction time is expected to equal or exceed two years, the credit may be claimed as progress expenditures are made on the project, rather than during the year the property is placed in service.

#### **Increased credit rate for solar energy property**

For property the construction of which begins before January 1, 2020, the credit rate for otherwise eligible solar energy property is increased to 30 percent. For property the construction of which begins in calendar year 2020 and that is placed in service by the end of calendar year 2023, the credit rate for otherwise eligible solar energy property is 26 percent. For property the construction of which begins in calendar year 2021 and that is placed in service by the end of calendar year 2023, the credit rate for otherwise eligible solar energy property is 22 percent. For property the construction of which begins after calendar year 2021 or that does not meet the 2023 deadline described above, the credit rate drops to the permanent 10-percent rate.

#### **Fiber optic solar property**

Equipment that uses fiber-optic distributed sunlight to illuminate the inside of a structure is eligible for a 30-percent credit for property the construction of which begins before January 1, 2020. For property the construction of which begins in calendar year 2020 and that is placed in service by the end of calendar year 2023, the credit rate is 26 percent. For property the

---

<sup>411</sup> Sec. 48.

<sup>412</sup> Sec. 38(b)(1).

<sup>413</sup> Sec. 50(c)(3).

construction of which begins in calendar year 2021 and that is placed in service by the end of calendar year 2023, the credit rate is 22 percent. No credit is available for property the construction of which begins after calendar year 2021 or that does not meet the 2023 placed-in-service deadlines.

#### Fuel cells

Qualified fuel cell property is eligible for a 30-percent credit for property the construction of which begins before January 1, 2020. For property the construction of which begins in calendar year 2020 and that is placed in service by the end of calendar year 2023, the credit rate is 26 percent. For property the construction of which begins in calendar year 2021 and that is placed in service by the end of calendar year 2023, the credit rate is 22 percent. No credit is available for property the construction of which begins after calendar year 2021 or that does not meet the 2023 placed-in-service deadlines.

Qualified fuel cell property means property comprising an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half kilowatt. The credit may not exceed \$1,500 for each 0.5 kilowatt of capacity.

#### Microturbines

Qualified microturbine property is eligible for 10-percent credit for property the construction of which begins before January 1, 2022. The credit is limited to the lesser of 10 percent of the basis of the property or \$200 for each kilowatt of capacity.

Qualified microturbine property means a qualified stationary microturbine power plant that is an integrated system composed of a gas turbine engine, a combustor, a recuperator or regenerator, a generator or alternator, and associated balance of plant components that converts a fuel into electricity and thermal energy. Such system also includes all secondary components located between the existing infrastructure for fuel delivery and the existing infrastructure for power distribution, including equipment and controls for meeting relevant power standards, such as voltage, frequency and power factors. Such system must have an electricity-only generation efficiency of not less than 26 percent at International Standard Organization conditions and a capacity of less than 2,000 kilowatts.

#### Geothermal heat pump property

Geothermal heat pump property is eligible for a 10-percent credit for property the construction of which begins before January 1, 2022. Qualified property is equipment that uses the ground or ground water as a thermal energy source to heat a structure or as a thermal energy sink to cool a structure.

#### Small wind energy property

Qualified small wind energy property is eligible for a 30-percent credit for property the construction of which begins before January 1, 2020. For property the construction of which

begins in calendar year 2020 and that is placed in service by the end of calendar year 2023, the credit rate is 26 percent. For property the construction of which begins in calendar year 2021 and that is placed in service by the end of calendar year 2023, the credit rate is 22 percent. No credit is available for property the construction of which begins after calendar year 2021 or that does not meet the 2023 placed-in-service deadlines.

Qualified small wind energy property is property that uses a qualified wind turbine to generate electricity. A qualifying wind turbine means a wind turbine of 100 kilowatts of rated capacity or less.

#### Combined heat and power system property

Qualified combined heat and power system (“CHP”) property is eligible for a 10-percent credit for property the construction of which begins before January 1, 2022.

CHP property is property: (1) that uses the same energy source for the simultaneous or sequential generation of electrical power, mechanical shaft power, or both, in combination with the generation of steam or other forms of useful thermal energy (including heating and cooling applications); (2) that has an electrical capacity of not more than 50 megawatts or a mechanical energy capacity of not more than 67,000 horsepower or an equivalent combination of electrical and mechanical energy capacities; (3) that produces at least 20 percent of its total useful energy in the form of thermal energy that is not used to produce electrical or mechanical power, and produces at least 20 percent of its total useful energy in the form of electrical or mechanical power (or a combination thereof); and (4) the energy efficiency percentage of which exceeds 60 percent. CHP property does not include property used to transport the energy source to the generating facility or to distribute energy produced by the facility.

The otherwise allowable credit with respect to CHP property is reduced to the extent the property has an electrical capacity or mechanical capacity in excess of any applicable limits. Property in excess of the applicable limit (15 megawatts or a mechanical energy capacity of more than 20,000 horsepower or an equivalent combination of electrical and mechanical energy capacities) is permitted to claim a fraction of the otherwise allowable credit. The fraction is equal to the applicable limit divided by the capacity of the property. For example, a 45 megawatt property would be eligible to claim 15/45ths, or one third, of the otherwise allowable credit. Again, no credit is allowed if the property exceeds the 50 megawatt or 67,000 horsepower limitations described above.

Additionally, systems whose fuel source is at least 90 percent open-loop biomass and that would qualify for the credit but for the failure to meet the efficiency standard are eligible for a credit that is reduced in proportion to the degree to which the system fails to meet the efficiency standard. For example, a system that would otherwise be required to meet the 60-percent efficiency standard, but which only achieves 30-percent efficiency, would be permitted a credit equal to one-half of the otherwise allowable credit (*i.e.*, a 5-percent credit).

## Description of Proposal

The proposal repeals the energy credit for solar, geothermal, fuel cell, microturbine, small wind, heat pump, and combined heat and power property.<sup>414</sup>

Effective date.—The proposal is effective for property the construction of which begins after December 31, 2019.

## Analysis

Generally, policymakers offer two broad rationales for intervention in the energy markets and for using tax policy to help effectuate these policy goals: to promote domestic energy independence and to reduce pollution.<sup>415</sup>

The energy investment credit incentivizes investment in certain types of energy property. By encouraging investment in renewable energy production or more efficient fossil-fuel energy production, this credit may help reduce the amount of energy imports. In addition, energy production from renewable sources or more efficient energy production from fossil-fuel sources may also reduce the amount of fossil-fuel pollution.

However, the energy investment credit may not be the most efficient way to achieve either main policy goal. There may be more direct ways to encourage domestic energy independence, and economists generally agree that the most efficient method to reduce pollution emissions is to impose a price on those emissions (through a tax or other mechanism) rather than to impose narrowly targeted subsidies or regulations.

---

<sup>414</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item V.D.

<sup>415</sup> For a recent discussion of the rationale behind energy tax provisions see Joint Committee on Taxation, *Federal Tax Provisions Expired in 2017 and 2018 and Expiring in 2019* (JCX-8-19), March 8, 2019.

## **E. Repeal Credit for Residential Energy Efficient Property**

### **Present Law**

#### **In general**

A personal tax credit is available for the purchase of qualified solar electric property and qualified solar water heating property that is used exclusively for purposes other than heating swimming pools and hot tubs.<sup>416</sup> In general, the credit rate is equal to 30 percent of qualifying expenditures.

A 30-percent credit is also available for the purchase of qualified geothermal heat pump property, qualified small wind energy property, and qualified fuel cell property.<sup>417</sup> The credit for any fuel cell may not exceed \$500 for each 0.5 kilowatt of capacity.

The credit is nonrefundable. The credit with respect to all qualifying property may be claimed against the alternative minimum tax.

The credit expires for property placed in service after December 31, 2021. The credit rate is reduced to 26 percent for property placed in service in calendar year 2020 and to 22 percent for property placed in service in calendar year 2021.

#### **Qualified property**

Qualified solar electric property is property that uses solar energy to generate electricity for use in a dwelling unit. Qualifying solar water heating property is property used to heat water for use in a dwelling unit located in the United States and used as a residence if at least half of the energy used by such property for such purpose is derived from the sun.

Qualified fuel cell property means property comprising an integrated system composed of a fuel cell stack assembly and associated balance of plant components that (1) converts a fuel into electricity using electrochemical means, and (2) has an electricity-only generation efficiency of greater than 30 percent and a capacity of at least one-half kilowatt. The property must be installed on or in connection with a dwelling unit located in the United States and used by the taxpayer as a principal residence.

Qualified small wind energy property is property that uses a wind turbine to generate electricity for use in a dwelling unit located in the U.S. and used as a residence by the taxpayer.

Qualified geothermal heat pump property means any equipment which (1) uses the ground or ground water as a thermal energy source to heat the dwelling unit or as a thermal energy sink to cool such dwelling unit, (2) meets the requirements of the Energy Star program which are in effect at the time that the expenditure for such equipment is made, and (3) is

---

<sup>416</sup> Sec. 25D.

<sup>417</sup> *Ibid.*

installed on or in connection with a dwelling unit located in the United States and used as a residence by the taxpayer.

### **Additional rules**

The depreciable basis of the property is reduced by the amount of the credit. Expenditures for labor costs allocable to onsite preparation, assembly, or original installation of property eligible for the credit are eligible expenditures.

Special proration rules apply in the case of jointly owned property, condominiums, and tenant-stockholders in cooperative housing corporations. If less than 80 percent of the property is used for nonbusiness purposes, only that portion of expenditures that is used for nonbusiness purposes is taken into account.

### **Description of Proposal**

The proposal repeals the credit for qualified solar electric, solar water heating, fuel cell, geothermal heat pump, and small wind property.<sup>418</sup>

Effective date.—The proposal is effective for property placed in service after December 31, 2019.

### **Analysis**

Generally, policymakers offer two broad rationales for intervention in the energy markets and for using tax policy to help effectuate these policy goals: to promote domestic energy independence and to reduce pollution.<sup>419</sup>

The credit for residential energy efficient property incentivizes the purchase of certain renewable-source property for use in a dwelling unit. Generally this renewable-source energy is produced on the site of the residence, with the exception of the fuel for fuel cells, and thus may reduce the amount of energy imports. In addition, use of renewable-source energy may also reduce the amount of fossil-fuel pollution.

However, the credit for residential energy efficient property may not be the most efficient way to achieve either main policy goal. There may be more direct ways to encourage domestic energy independence, and economists generally agree that the most efficient method to reduce pollution emissions is to impose a price on those emissions (through a tax or other mechanism) rather than to impose narrowly targeted subsidies or regulations.

---

<sup>418</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item V.E.

<sup>419</sup> For a recent discussion of the rationale behind energy tax provisions see Joint Committee on Taxation, *Federal Tax Provisions Expired in 2017 and 2018 and Expiring in 2019* (JCX-8-19), March 8, 2019.

## PART VI – MISCELLANEOUS

### A. Reinstate the Oil Spill Liability Trust Fund Excise Tax

#### Present Law

The Oil Spill Liability Trust Fund is used to pay costs related to oil spill removal activities, natural resource damage assessments, and unpaid damages claims. Generally the liability of a party responsible for an oil spill is limited. There is liability for all removal costs, but liability for other damages and costs is capped at \$75 million. Money from the Fund may be used to pay such claims up to and beyond the responsible party's limit. There is a general limit of \$1 billion per incident that may be paid out of the Oil Spill Liability Trust Fund, with costs of natural resource damage assessments and claims for any single incident limited to \$500 million.

Prior to expiration on December 31, 2018, the Oil Spill Liability Trust Fund financing rate (“oil spill tax”) was nine cents per barrel. It generally applied to crude oil received at a U.S. refinery and to petroleum products entered into the United States for consumption, use, or warehousing.<sup>420</sup> Additionally, if any domestic crude oil was used in or exported from the United States, and before such use or exportation no oil spill tax was imposed on such crude oil, then the oil spill tax was imposed on such crude oil.<sup>421</sup> The tax does not apply to any use of crude oil for extracting oil or natural gas on the premises where such crude oil was produced.

For crude oil received at a refinery, the operator of the U.S. refinery is liable for the tax. For imported petroleum products, the person entering the product into the United States for consumption, use, or warehousing is liable for the tax. For certain uses and exports, the person using or exporting the crude oil is liable for the tax. No tax was imposed with respect to any petroleum product if the person who would be liable for such tax established that a prior oil spill tax had been imposed with respect to such product.

As noted above, the tax expired December 31, 2018.

#### Description of Proposal

The proposal reinstates the oil spill tax.<sup>422</sup>

Effective date.—The proposal is effective at the applicable rate (nine cents per barrel) on such crudes received at a U.S. refinery, entered into the United States, or used or exported after December 31, 2019.

---

<sup>420</sup> The term “crude oil” includes crude oil condensates and natural gasoline. The term “petroleum product” includes crude oil.

<sup>421</sup> The term “domestic crude oil” means any crude oil produced from a well located in the United States.

<sup>422</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President’s Fiscal Year 2020 Budget Proposal*, Item VI.

### **Analysis**

There are concerns that a significant oil spill could deplete the Oil Spill Liability Trust Fund leaving it diminished and insufficient for subsequent spills. As a result, reinstating the tax financing rate may ensure further stability of the trust fund. Opponents of an increase would argue that the tax requires that the entire oil industry share the burden of the party responsible for the spill and that instead liability limits should be increased.

## **B. Reform Inland Waterways Financing**

### **Present Law**

#### **Tax and exemptions**

A 29-cents-per-gallon excise tax is imposed on fuel used in powering commercial cargo vessels on a designated system of inland or intra-coastal waterways (the “inland waterways excise tax”).<sup>423</sup> This tax is permanent. The tax applies to fuel used on any specified inland or intra-coastal waterway of the United States in the business of transporting property (other than fish or other aquatic animal life caught on the voyage) for compensation or hire, or in transporting property in the business of the owner, lessee, or operator of the vessel other than fish or other aquatic animal life caught on the voyage.<sup>424</sup> The inland waterways excise tax is a use tax imposed on the boat operator.

Exemptions are provided for vessels designed primarily for use on the high seas which have a draft of more than 12 feet (“deep-draft ocean-going vessels”), for vessels used primarily for transportation of persons, and for State or local government vessels engaged in governmental business.<sup>425</sup>

#### **Overview of Inland Waterways Trust Fund expenditure provisions**

Operation of the Inland Waterways Trust Fund is governed by parallel provisions of the Code and authorizing statutes.<sup>426</sup> The Code provisions govern deposit of receipts from the fuel tax into the Trust Fund and approve general expenditure purposes. The authorizing statutes specify expenditure programs.

Amounts in the Inland Waterways Trust Fund are available, as provided by appropriation Acts, for making construction and rehabilitation expenditures for navigation on the inland and coastal waterways of the United States described in section 206 of the Inland Waterways Revenue Act of 1978, as in effect on the date of the enactment of Code section 9506. There is a limit of 50 percent that may be paid from the Inland Waterways Trust Fund for the cost of any construction under section 102(a) of the Water Resources Development Act of 1986 (as in effect

---

<sup>423</sup> Sec. 4042. Like other taxable motor fuels, inland waterway fuels are subject to an additional excise tax of 0.1 cents per gallon to fund the LUST Trust Fund.

<sup>424</sup> The term inland or intra-coastal waterway of the United States means any inland or intra-coastal waterway of the United States which is described in section 206 of the Inland Waterways Revenue Act of 1978 and includes the Mississippi River upstream from Baton Rouge, Louisiana, the Mississippi River’s tributaries, and specified waterways, including the Gulf of Mexico and Atlantic Intra-coastal Waterways, and the Tennessee-Tombigbee Waterway.

<sup>425</sup> Sec. 4042(c)(4) also provides an exemption with respect to use for movement by tug of exclusively LASH (lighter-aboard-ship) and SEABEE ocean-going barges released by their ocean going carriers solely to pick up or deliver international cargoes. However, LASH and SEABEE vessels are no longer in use.

<sup>426</sup> Sec. 9506 and 33 U.S.C. sec. 2212.

on the date of enactment of Code sec. 9506). The remaining 50 percent is to be paid from the General Fund. The Army Corps of Engineers is responsible for the construction, operation, and maintenance of inland waterway infrastructure

In addition to tax revenues, the Inland Waterways Trust Fund also earns investment interest on its unexpended balances. In fiscal year 2019, \$119 million is expected to be collected from the inland waterway fuel tax and the trust fund is expected to earn \$3 million in interest. At the end of fiscal year 2019, the trust fund is projected to have a balance of \$137 million.<sup>427</sup>

### **Description of Proposal**

The proposal reforms the laws governing the Inland Waterways Trust Fund, including an annual per-vessel fee for commercial users, to help finance future capital investments on these waterways and a portion of the cost of operating and maintaining them.<sup>428</sup>

Effective date.—The proposal is effective as of January 1, 2020.

### **Analysis**

The nation's waterway infrastructure is aging, and there will be an increasing need to replace it. This will require additional funds. The President's budget proposal seeks to raise these additional funds through the imposition of a user fee in lieu of the present inland waterways excise tax.

Some argue that the excise tax is an inefficient method for raising the necessary funds and that user fees should be imposed on the basis of the costs of the projects. Proponents argue a fee based on the cost to improve a lock that is imposed on the user of such lock would be more equitable than a tax imposed on all users regardless of whether they will use the facilities since the beneficiaries of the construction project would be paying for its cost. It is not clear from the proposal whether the fees will be set according to each project or set based on an aggregate level of spending to be incurred for that fiscal year. If the same rate applies regardless of the facility being used, the arguments that a fee is more efficient and equitable than a tax are not as strong because the fee does not vary according to needs and use.

Some argue that a fee structure allows for more flexibility than a tax, allowing the fees to be increased when needed to meet construction needs and reduced when that level of spending is no longer needed. Adjusting the tax requires action by Congress. Most recently, Congress increased the tax by 45 percent, from 20 cents per gallon to 29 cents per gallon. Some argue that

---

<sup>427</sup> Congressional Budget Office, *CBO January 2019 Baseline Estimates of Spending and Revenues for the Inland Waterways Trust Fund (IWTF) Prepared for Joint Committee on Taxation* reprinted in Joint Committee on Taxation, *Overview of Selected Internal Revenue Code Provisions Relating to the Financing of Public Infrastructure* (JCX-7-19), March 4, 2019, Table 3, p. 14.

<sup>428</sup> The estimated budgetary effect of this proposal can be found in the appendix to this document, *Estimated Budget Effects of the Revenue Provisions Contained in the President's Fiscal Year 2020 Budget Proposal*, Item VII.

a similar authority to set and increase fees should not be delegated to an agency but retained by Congress.

A user fee also could reduce congestion on the waterways as some look for alternate means of transportation to avoid the fee. However, while reducing congestion on waterways, it could adversely affect congestion on roadways if commercial shipping by barge switches to highway transportation methods.

**APPENDIX – ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS  
CONTAINED IN THE PRESIDENT’S FISCAL YEAR 2020 BUDGET PROPOSAL**

**ESTIMATED BUDGET EFFECTS OF THE REVENUE PROVISIONS CONTAINED IN  
THE PRESIDENT'S FISCAL YEAR 2020 BUDGET PROPOSAL [1]**

**Fiscal Years 2019 - 2029**

*[Millions of Dollars]*

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019-24	2019-29
<b>I. Make Permanent Certain Tax Cuts Enacted in 2017</b>														
A. Simplification and Reform of Rates, Standard Deductions, and Exemptions														
1. 10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets [2][3].....	tyba 12/31/25	---	---	---	---	---	---	---	-131,475	-195,833	-205,442	-214,542	---	-747,292
2. Modify standard deduction (\$12,000 for singles, \$24,000 for married filing jointly, \$18,000 for HoH) [3].....	tyba 12/31/25	---	---	---	---	---	---	---	-67,192	-114,391	-118,797	-124,133	---	-424,513
3. Repeal of deduction for personal exemptions [3].....	tyba 12/31/25	---	---	---	---	---	---	---	125,674	184,557	191,456	198,437	---	700,124
B. Treatment of Business Income of Individuals, Trusts, and Estates														
1. Allow 20 percent deduction of qualified business income and certain dividends for individuals and deduction of certain income of agricultural or horticultural cooperatives.....	tyba 12/31/25	---	---	---	---	---	---	-5,742	-38,427	-64,920	-70,518	-71,686	---	-251,293
2. Disallow active passthrough losses in excess of \$500,000 for joint filers, \$250,000 for all others.....	tyba 12/31/25	---	---	---	---	---	---	---	13,082	22,254	22,981	23,754	---	82,071
C. Reform of the Child Tax Credit														
1. Modification of child tax credit: \$2,000 not indexed; refundable up to \$1,400 indexed down to nearest \$100 base year 2018; \$2,500 refundability threshold not indexed; \$500 other dependents not indexed; phase outs \$200K/\$400K not indexed [3].....	tyba 12/31/25	---	---	---	---	---	---	---	-36,275	-80,767	-83,012	-84,412	---	-284,467
2. Require a valid Social Security number ("SSN") for each child to claim refundable and non-refundable portions of the child tax credit ("CTC"), non-child dependents and any child without a valid SSN still receives \$500 non-refundable credit [3].....	tyba 12/31/25	---	---	---	---	---	---	---	585	3,272	3,571	3,797	---	11,224

124

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019-24	2019-29
-----------	-----------	------	------	------	------	------	------	------	------	------	------	------	---------	---------

<b>D. Simplification and Reform of Deductions and Exclusions</b>														
1. Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to \$10,000 in State and local taxes), interest on mortgage debt in excess of \$750K, interest on home equity debt, non-disaster casualty losses, and certain miscellaneous expenses [3].....	generally tyba 12/31/25	---	---	---	---	---	---	---	71,419	116,473	117,194	122,745	---	427,831
2. Increase percentage limit for charitable contributions of cash to public charities.....	cmi tyba 12/31/25	----- Estimate Included in Item I.D.1. -----												
3. Repeal of overall limitation on itemized deductions.....	tyba 12/31/25	----- Estimate Included in Item I.D.1. -----												
4. Repeal exclusion for employer-provided bicycle commuter fringe benefit [4].....	tyba 12/31/25	---	---	---	---	---	---	---	9	12	12	13	---	46
5. Repeal exclusion for employer-provided qualified moving expense reimbursements (other than members of the Armed Forces) [5][6].....	tyba 12/31/25	---	---	---	---	---	---	---	478	651	669	688	---	2,485
6. Repeal of deduction for moving expenses (other than members of the Armed Forces).....	tyba 12/31/25	---	---	---	---	---	---	---	766	1,058	1,103	1,148	---	4,075
7. Limitation on wagering losses.....	tyba 12/31/25	---	---	---	---	---	---	---	2	15	15	16	---	49
E. Double Estate, Gift, and GST Tax Exemption Amount.....	dda & gma 12/31/25	---	---	---	---	---	-53	-384	-1,130	-12,799	-14,608	-15,422	-53	-44,397
F. Increase the Individual AMT Exemption Amounts and Phase-out Thresholds.....	tyba 12/31/25	---	---	---	---	---	---	---	-34,518	-115,890	-119,645	-125,727	---	-395,780
<b>G. Other Provisions</b>														
1. Allow for increased contributions to ABLE accounts; allow Saver's credit for ABLE contributions.....	tyba 12/31/25	---	---	---	---	---	---	---	-1	-1	-1	-1	---	-4
2. Allow rollovers from 529 accounts to ABLE accounts.....	da 12/31/25	---	---	---	---	---	---	---	-1	-1	-1	-1	---	-4
3. Treatment of certain individuals performing services in the Sinai Peninsula of Egypt.....	spo/a 12/31/25	---	---	---	---	---	---	---	-1	-1	-1	-1	---	-5
4. Treatment of student loans discharged on account of death or disability.....	doia 12/31/25	---	---	---	---	---	---	---	-1	-14	-14	-15	---	-43
<b>Total of Make Permanent Certain Tax Cuts Enacted in 2017 .....</b>		---	---	---	---	---	<b>-53</b>	<b>-6,126</b>	<b>-97,006</b>	<b>-256,325</b>	<b>-275,038</b>	<b>-285,342</b>	<b>-53</b>	<b>-919,893</b>

**II. Health Proposals**

<b>A. Empowering States and Consumers to Reform Healthcare [7][8].....</b>														
	[9]	---	-373	-4,126	-8,292	-14,621	-19,018	-21,700	-24,710	-27,386	-29,677	-31,171	-46,430	-181,075
<b>B. Modifications and Repeal of Premium Tax Credit:</b>														
1. Minimum contribution for premium assistance credit eligibility [3][7].....	tyba 12/31/19	---	227	76	---	---	---	---	---	---	---	---	303	303
2. Repeal of premium assistance credit.....	tyba 12/31/20	----- Estimate Included in Item II.A. -----												
3. Reduce the grace period for Exchange premiums [3][7].....	tyba 12/31/19	---	146	62	---	---	---	---	---	---	---	---	208	208
C. Repeal of Employer Shared Responsibility Penalty.....	mba 12/31/18	----- Estimate Included in Item II.A. -----												
<b>D. Improve and Expand Access to Health Savings Accounts [10].....</b>														
	tyba 12/31/20	---	---	-1,921	-2,846	-3,016	-3,209	-3,451	-3,665	-3,898	-4,138	-4,350	-10,992	-30,494

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019-24	2019-29
<b>E. Allow Medicare Beneficiaries to Contribute to Health Savings Accounts ("HSAs") and Medical Savings Accounts ("MSAs") [7][11].....</b>														
	tyba 12/31/20	---	---	-301	-792	-1,267	-1,472	-1,577	-1,652	-1,724	-1,785	-1,223	-3832	-11,793
<b>F. Reform Medical Liability [7][12].....</b>														
	tyba 12/31/19	---	-8	-56	-163	-284	-332	-352	-372	-392	-413	-438	-843	-2,810
<b>G. Repeal of Elimination of Deduction for Expenses Allocable to Medicare Part D Subsidy.....</b>														
	tyba 12/31/19	----- <i>Estimate Included in Item II.A.</i> -----												
<b>H. Distributions and Reimbursements for Over-the-Counter Medications.....</b>														
	tyba 12/31/19	----- <i>Estimate Included in Item II.A.</i> -----												
<b>I. Repeal of Small Business Healthcare Tax Credit.....</b>														
	tyba 12/31/20	----- <i>Estimate Included in Item II.A.</i> -----												
<b>J. Repeal of Medical Device Excise Tax.....</b>														
	sa 12/31/20	----- <i>Estimate Included in Item II.A.</i> -----												
<b>Total of Health Proposals.....</b>		---	<b>-8</b>	<b>-6,266</b>	<b>-12,093</b>	<b>-19,188</b>	<b>-24,031</b>	<b>-27,080</b>	<b>-30,399</b>	<b>-33,400</b>	<b>-36,013</b>	<b>-37,182</b>	<b>-61,586</b>	<b>-225,661</b>
<b>III. Education Tax Benefits</b>														
<b>A. Establish Education Freedom Scholarships.....</b>														
	tyba 12/31/19	---	-1,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-5,000	-21,000	-46,000
<b>B. Provide Tax Exemption for Indian Health Service ("IHS") Health Professions, NURSE Corps, and Native Hawaiian Scholarship and Loan Repayment Programs in Return for Obligatory Service Requirement [13].....</b>														
	tyba 12/31/19	---	-21	-29	-29	-29	-30	-30	-34	-35	-35	-36	-138	-308
<b>Total of Education Tax Benefits.....</b>		---	<b>-1,021</b>	<b>-5,029</b>	<b>-5,029</b>	<b>-5,029</b>	<b>-5,030</b>	<b>-5,030</b>	<b>-5,034</b>	<b>-5,035</b>	<b>-5,035</b>	<b>-5,036</b>	<b>-21,138</b>	<b>-46,308</b>
<b>IV. Tax Administration</b>														
<b>A. Provide Discretionary Funding for IRS Program Integrity Cap Adjustment [14].....</b>														
	DOE	----- <i>No Scorable Revenue Effect</i> -----												
<b>B. Increase Oversight of Paid Tax Return Preparers [3].....</b>														
	DOE	---	6	13	14	15	17	18	19	20	21	22	66	164
<b>C. Provide More Flexible Authority for the Internal Revenue Service to Address Correctable Errors [3].....</b>														
	tyba 12/31/19	---	---	30	30	31	32	33	34	35	36	37	123	300
<b>D. Expand Mandatory Electronic Filing of W-2s [3].....</b>														
	tyba 12/31/19	---	---	5	5	5	4	4	4	4	4	3	18	38
<b>E. Improve Clarity in Worker Classification Requirements and Information Reporting Requirements [3][15].....</b>														
	[16]	---	12	250	71	71	68	67	63	59	54	48	472	763
<b>F. Require a SSN that is Valid for Work in Order to Claim CTC, Earned Income Tax Credit ("EITC"), and/or Credit for Other Dependents ("ODTC") [3][17].....</b>														
	tyba 12/31/19	---	178	3,577	3,617	3,680	3,690	3,708	3,763	3,840	3,957	4,023	14,742	34,033
<b>Total of Tax Administration.....</b>		---	<b>196</b>	<b>3,875</b>	<b>3,737</b>	<b>3,802</b>	<b>3,811</b>	<b>3,830</b>	<b>3,883</b>	<b>3,958</b>	<b>4,072</b>	<b>4,133</b>	<b>15,421</b>	<b>35,298</b>
<b>V. Energy Tax Benefits</b>														
<b>A. Repeal the Qualified Plug-In Electric Drive Motor Vehicle Credit.....</b>														
	1/1/20	---	421	833	839	876	843	728	603	475	411	392	3,812	6,421
<b>B. Repeal Exclusion of Utility Conservation Subsidies.....</b>														
	1/1/20	---	2	8	7	7	7	6	6	7	6	6	30	62
<b>C. Repeal Accelerated Depreciation for Renewable Energy Property.....</b>														
	1/1/20	---	2	6	9	8	5	2	[18]	-2	-3	-3	31	26

Provision	Effective	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019-24	2019-29
D. Repeal Energy Investment Credit.....	ceb 1/1/20	---	1,959	3,823	4,431	4,690	3,605	2,729	2,585	2,424	2,062	1,790	18,508	30,099
E. Repeal Credit for Residential Energy Efficient Property.....	ppisa 12/31/19	327	1,276	1,023	424	---	---	---	---	---	---	---	3,050	3,050
<b>Total of Energy Tax Benefits.....</b>		<b>327</b>	<b>3,660</b>	<b>5,693</b>	<b>5,710</b>	<b>5,581</b>	<b>4,460</b>	<b>3,465</b>	<b>3,194</b>	<b>2,904</b>	<b>2,476</b>	<b>2,185</b>	<b>25,431</b>	<b>39,658</b>
<b>VI. Reauthorize the Oil Spill Liability Trust Fund Excise Tax.....</b>	<b>1/1/20</b>	----- <i>No Revenue Effect</i> -----												
<b>VII. Reform Inland Waterways Financing.....</b>	<b>DOE</b>	----- <i>Proposal Requires Further Specification</i> -----												
<b>NET TOTAL .....</b>		<b>327</b>	<b>2,827</b>	<b>-1,727</b>	<b>-7,675</b>	<b>-14,834</b>	<b>-20,843</b>	<b>-30,941</b>	<b>-125,362</b>	<b>-287,898</b>	<b>-309,538</b>	<b>-321,242</b>	<b>-41,925</b>	<b>-1,116,906</b>

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding. The date of enactment is generally assumed to be July 1, 2019.

Legend for "Effective" column:

ceb - credits earned beginning  
cmi = contributions made in  
da = distributions after  
dda = decedents dying after

doia = discharge of indebtedness after  
gma = gifts made after  
mba = months beginning after  
ppisa = property placed in service after

sa = sales after  
spo/a = service provided on or after  
tyba = taxable years beginning after

127

[1] To the extent the proposals are not fully specified, estimates will be updated as new information becomes available and policy intent is clarified.

[2] The parameters for the beginning of the 24%, 32%, 35%, and 37% rate brackets, and the standard deduction amount use 2018 as the base year. Other indexed parameters are adjusted for inflation from their 2017 values using the chained CPI-U as the inflation measure to determine 2018 values.

[3] Estimate includes the following outlay effects:	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2019-24	2019-29
10%, 12%, 22%, 24%, 32%, 35%, and 37% income tax rate brackets.....	---	---	---	---	---	---	---	---	853	854	850	---	2,557
Modify standard deduction.....	---	---	---	---	---	---	---	---	9,292	9,407	9,538	---	28,237
Repeal of deduction for personal exemptions.....	---	---	---	---	---	---	---	---	-16,157	-16,463	-16,712	---	-49,332
Modification of child tax credit.....	---	---	---	---	---	---	---	---	24,122	25,103	25,247	---	74,472
Require a valid Social Security number ("SSN") for each child to claim refundable and non-refundable portions of the child tax credit ("CTC"), non-child dependents and any child without a valid SSN still receives \$500 non-refundable credit .....	---	---	---	---	---	---	---	---	-2,298	-2,487	-2,637	---	-7,422
Repeal of itemized deductions for taxes not paid or accrued in a trade or business (except for up to \$10,000 in State and local taxes), interest on mortgage debt in excess of \$750K, interest on home equity debt, non-disaster casualty losses and certain miscellaneous expenses.....	---	---	---	---	---	---	---	---	-398	-225	-212	---	-835
Minimum contribution for premium assistance tax credit eligibility.....	---	-291	-97	---	---	---	---	---	---	---	---	-388	-388
Reduce the grace period for exchange premiums.....	---	27	12	---	---	---	---	---	---	---	---	39	39
Increase oversight of paid tax return preparers.....	---	-2	-4	-5	-5	-6	-6	-6	-7	-7	-7	-22	-55

[Footnotes for the Table continue on the following pages]

**Footnotes for the Table continued:**

	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
[3] Estimate includes the following outlay effects (continued):													
Provide more flexible authority for the Internal Revenue Service to address correctable errors.....	---	---	-18	-19	-20	-20	-21	-21	-22	-23	-23	-77	-187
Expand mandatory electronic filing of W-2s .....	---	---	-3	-3	-3	-3	-3	-2	-2	-2	-2	-11	-22
Improve clarity in worker classification and information reporting requirements.....	---	---	20	21	23	24	26	27	29	31	33	88	234
Require a SSN that is valid for work in order to claim CTC, EITC and/or ODTC.....	---	---	-1,827	-1,802	-1,823	-1,784	-1,741	-1,743	-1,712	-1,739	-1,729	-7,236	-15,900
[4] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	---	---	---	---	---	---	9	12	12	13	---	46
On-budget effects.....	---	---	---	---	---	---	---	6	8	8	8	---	29
Off-budget effects.....	---	---	---	---	---	---	---	3	4	4	5	---	17
[5] Estimate includes policy that retains exclusion under section 217(g) (related to members of the Armed Forces).													
[6] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	---	---	---	---	---	---	478	651	669	688	---	2,485
On-budget effects.....	---	---	---	---	---	---	---	378	514	529	544	---	1,964
Off-budget effects.....	---	---	---	---	---	---	---	100	137	140	144	---	522
[7] Estimate provided by the Joint Committee on Taxation and the Congressional Budget Office.													
[8] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	-373	-4,126	-8,292	-14,621	-19,018	-21,700	-24,710	-27,386	-29,677	-31,171	-46,430	-181,075
On-budget effects.....	---	-268	-3,151	-5,408	-9,788	-12,880	-14,671	-17,286	-19,490	-21,264	-22,124	-31,497	-126,331
Off-budget effects.....	---	-105	-975	-2,883	-4,833	-6,137	-7,029	-7,425	-7,897	-8,413	-9,047	-14,933	-54,744
[9] Estimate assumes provisions are effective for taxable years beginning after December 31, 2020, unless otherwise noted in line items.													
[10] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	---	-1,921	-2,846	-3,016	-3,209	-3,451	-3,665	-3,898	-4,138	-4,350	-10,992	-30,494
On-budget effects.....	---	---	-1,660	-2,454	-2,592	-2,749	-2,954	-3,130	-3,325	-3,525	-3,694	-9,454	-26,082
Off-budget effects.....	---	---	-261	-392	-424	-460	-497	-535	-573	-613	-656	-1,538	-4,412
[11] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	---	-301	-792	-1,267	-1,472	-1,577	-1,652	-1,724	-1,785	-1,223	-3,832	-11,793
On-budget effects.....	---	---	-204	-538	-863	-1,005	-1,076	-1,127	-1,177	-1,254	-875	-2,609	-8,117
Off-budget effects.....	---	---	-97	-254	-404	-467	-501	-525	-547	-531	-348	-1,223	-3,675
[12] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	-8	-56	-163	-284	-332	-352	-372	-392	-413	-438	-843	-2,810
On-budget effects.....	---	25	127	358	627	742	793	842	890	941	998	1,879	6,343
Off-budget effects.....	---	-33	-183	-521	-911	-1,074	-1,145	-1,214	-1,282	-1,354	-1,436	-2,722	-9,153
[13] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	-21	-29	-29	-29	-30	-30	-34	-35	-35	-36	-138	-308
On-budget effects.....	---	-16	-22	-22	-23	-23	-23	-26	-28	-28	-28	-107	-241
Off-budget effects.....	---	-5	-6	-7	-7	-7	-7	-7	-7	-7	-8	-31	-68

[Footnotes for the Table continue on the following page]

**Footnotes for the Table continued:**

[14] Estimate provided by the Congressional Budget Office.

[15] Estimate includes the following budget effects:	<u>2019</u>	<u>2020</u>	<u>2021</u>	<u>2022</u>	<u>2023</u>	<u>2024</u>	<u>2025</u>	<u>2026</u>	<u>2027</u>	<u>2028</u>	<u>2029</u>	<u>2019-24</u>	<u>2019-29</u>
Total Revenue Effect.....	---	12	250	71	71	68	67	63	59	54	48	472	763
On-budget effects.....	---	27	229	138	146	153	162	170	179	189	199	692	1,592
Off-budget effects.....	---	-15	21	-67	-75	-85	-96	-107	-120	-135	-151	-221	-829

[16] Improve clarity in worker classification is effective for services provided after December 31, 2019. Information reporting requirements are effective for payments made after December 31, 2019.

[17] This proposal is in addition to the proposal in I.C.2 to make permanent the requirement for a valid SSN for each child to claim the refundable and non-refundable portions of the CTC.

[18] Loss of less than \$500,000.