

**SUMMARY OF TAX PROVISIONS
CONTAINED IN THE PRESIDENT'S
FISCAL YEAR 2002 BUDGET PROPOSAL**

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of the
JOINT COMMITTEE ON TAXATION



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INTRODUCTION

This document,¹ prepared by the staff of the Joint Committee on Taxation, provides a summary of the tax provisions contained in the President's Fiscal Year 2002 Budget Proposal. This document generally follows the order of the proposals as included in the Department of Treasury explanation of the proposals.²

¹ This document may be cited as follows: Joint Committee on Taxation, *Summary of Tax Provisions Contained in the President's Fiscal Year 2002 Budget Proposal* (JCX-30-01), May 4, 2001.

² See Department of the Treasury, *General Explanations of the Administration's Fiscal Year 2002 Tax Relief Proposals*, April 2001.

SUMMARY OF TAX PROVISIONS CONTAINED IN THE PRESIDENT'S FISCAL YEAR 2002 BUDGET PROPOSAL

A. The President's Agenda for Tax Relief Presented to Congress on February 8th

1. Create new 10-percent individual income tax rate

The President's budget proposal would establish a new 10-percent regular income tax rate bracket for a portion of taxable income that is currently subject to tax at a 15-percent rate. The 10-percent rate would be phased in from 2002 through 2006, as shown in Table 1, below. After 2006, the rate brackets would be adjusted annually for inflation.

Table 1.--Proposed New 10-Percent Rate Bracket

Calendar Year	Taxable Income			Proposed New Rate
	Single Individuals	Heads of Households	Married Filing Joint Returns	
2002	0-\$6,000	0-\$10,000	0-\$12,000	14 percent
2003	0-\$6,000	0-\$10,000	0-\$12,000	13 percent
2004	0-\$6,000	0-\$10,000	0-\$12,000	12 percent
2005	0-\$6,000	0-\$10,000	0-\$12,000	11 percent
2006	0-\$6,000	0-\$10,000	0-\$12,000	10 percent
2007 and later	Adjust annually for inflation			10 percent

2. Reduce individual income tax rates

The President's budget proposal would replace the five present-law individual statutory rates (15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent) with four individual statutory rates (10 percent, 15 percent, 25 percent, and 33 percent). The 10-percent rate and 15-percent rate are described, above. Table 2, below, shows the schedule of proposed other regular income tax rate reductions under the budget proposal.

Table 2.--Proposed Regular Income Tax Rate Reductions

Calendar Year	28% Rate Reduced to:	31% Rate Reduced to:	36% Rate Reduced to:	39.6% Rate Reduced to:
2002	27%	30%	35%	38%
2003	27%	29%	35%	37%
2004	26%	28%	34%	36%
2005	26%	27%	34%	35%
2006 and later	25%	25%	33%	33%

The tax rate reductions also would apply to estates and trusts.

3. Increase the child tax credit

The President's budget proposal would increase the size of the child tax credit from \$500 to \$1,000. This increase would be phased in as shown in Table 3, below.

Table 3.--Proposed Increase in Child Credit

Year	Maximum Per Child Credit
2002	\$600
2003	\$700
2004	\$800
2005	\$900
2006 and later	\$1,000

The beginning point of the phase-out range of the child tax credit also would be increased to \$200,000 of modified adjusted gross income for married couples filing a joint return, unmarried individuals, and heads of households (\$100,000 of modified adjusted gross income for married couples filing separate returns). This increase would be phased in over five years (2002-2006). Starting in 2002, the present-law beginning points of the child tax credit phase-out range (\$110,000 for married couples filing jointly; \$75,000 for unmarried individuals and heads of households; and \$55,000 for a married person filing separately) would be increased each year by \$18,000 for married couples filing a joint return; \$25,000 for unmarried individuals and heads of households; and \$9,000 for married couples filing separate returns, respectively.

The proposal would reduce the phase-out rate of the child tax credit from \$50 to \$20 for each \$1,000 (or fraction thereof) of the taxpayer's modified adjusted gross income above the beginning point of the applicable phase-out range, effective for taxable years beginning after December 31, 2005.

The proposal would allow the child tax credit to be claimed both for regular income tax and alternative minimum tax purposes. In addition, the proposal would provide that refundable credits are not reduced by the alternative minimum tax.

4. Reduction in the marriage penalty

The President's budget proposal would create a two-earner deduction for married couples filing a joint return, effective for taxable years beginning after December 31, 2001. This deduction would be an above-the-line deduction equal to 10-percent of the lesser earning spouse's annual earned income up to \$30,000. Earned income would be defined as the sum of wages, salaries, and net income from self-employment less certain deductions. The proposal would be phased in, as indicated in Table 4, below.

Table 4.--Phase-In of Two-Earner Deduction

Year	Maximum Earned Income Amount
2002	\$6,000
2003	\$12,000
2004	\$18,000
2005	\$24,000
2006 and later	\$30,000

5. Provide charitable contribution deduction for nonitemizers

The President's budget proposal would allow taxpayers who do not itemize their deductions to deduct their charitable contributions (up to the amount of the standard deduction) in addition to their standard deduction. The proposal would be effective for charitable contributions made in taxable years beginning after December 31, 2001, and would be phased in between 2002 and 2006.

6. Permit tax-free withdrawals from individual retirement arrangements ("IRAs") for charitable contributions

The President's budget proposal would permit individuals to exclude from gross income distributions made after age 59-1/2 from a traditional or Roth IRA, if the distribution is made directly to a qualified charitable organization. No deduction would be allowed for otherwise taxable amounts that are excluded from income under the proposal. This proposal would be effective for distributions after December 31, 2001.

7. Raise the cap on corporate charitable contributions

The President's budget proposal would increase the present-law 10-percent of net income limit on charitable contributions by corporations to 15 percent, effective for contributions deductible in taxable years beginning after December 31, 2001.

8. Increase and expand education savings accounts

The President's budget proposal would (1) allow tax-free distributions from education savings accounts (referred to as education IRAs under present law) for certain elementary, secondary, and after-school program expenses; (2) phase in an increase in the annual contribution limit to education savings accounts from \$500 to \$5,000; and (3) permit a tax-free distribution from an education savings account in the same year that a Hope or Lifetime Learning credit is claimed as long as the distribution is not used for the same expenses for which the credit is claimed. Table 5, below, shows the proposed phase in of the increase in the annual contribution limit to education savings accounts.

Table 5.--Proposed Increase in Education Savings Account Annual Contribution Limit

Year	Annual Contribution Limit
2002	\$1,000
2003	\$2,000
2004	\$3,000
2005	\$4,000
2006 and later	\$5,000

The proposal would be effective for contributions to and distributions from education savings accounts after December 31, 2001.

9. Permanently extend the research and experimentation (R&E) tax credit

The President's budget proposal would make permanent the section 41 research and experimentation tax credit. The credit is scheduled to expire under present law on June 30, 2004.

10. Phase out and repeal of estate, gift, and generation-skipping transfer taxes

In general

The President's budget proposal would repeal estate, gift, and generation-skipping transfer taxes in 2009. Prior to repeal, the estate, gift, and generation-skipping transfer taxes would be phased out between 2002 and 2008.

In 2002, the 5-percent surtax (which phases out the benefit of the graduated rates) would be repealed. Moreover, each estate and gift tax rate would be reduced by 5 percentage points in 2002, 10 percentage points in 2004, 15 percentage points in 2005, 20 percentage points in 2006, 30 percentage points in 2007, and 40 percentage points in 2008. No estate and gift tax rate would fall below the highest statutory income tax rate generally applicable to long-term capital gains. The highest estate and gift tax rate in effect for a given year would be the generation-skipping transfer tax rate for that year. In 2008, the unified credit exemption equivalent amount would be increased to \$1.3 million. Technical modifications also would be made to the generation-skipping transfer tax.

In 2009, the estate, gift, and generation-skipping transfer taxes would be eliminated. After repeal, the basis of assets received from a decedent generally would be the lower of the fair market value on the date of the decedent's death or the adjusted basis of the property immediately before the death of the decedent. However, an executor would be permitted to increase the basis by the sum of: (1) a total of \$1.3 million; (2) any of the decedent's unused capital loss carryforwards, unused net operating loss carryforwards, and the difference between the decedent's basis and fair market value on assets that are assigned a fair market value basis; and (3) \$3 million of property transferred to a surviving spouse. The \$1.3 million and \$3 million amounts would be indexed for inflation after 2009. No basis could be added to: (1) property acquired by the decedent by gift (other than from a spouse) during the three-year period ending on the date of the decedent's death; (2) property that constitutes a right to receive income in

respect of a decedent; or (3) stock of certain foreign entities (e.g., foreign personal holding companies and domestic international sales corporations).

The President's budget proposal also would extend the present-law exclusion of the gain on the sale of a principal residence to an heir who sells the decedent's residence within three years of the decedent's death. Moreover, the proposal provides that distribution by an estate of an asset secured by indebtedness would not be a disposition; there would be limitations on income tax deductions of the estate; and rules would be provided to prevent disparate treatment of pecuniary, fractional, and formula bequests. In addition, there would be a provision for disclaimer of bequests within nine months of death and treatment of art inherited from the artist as a capital asset. There also would be a general anti-abuse rule.

Reporting requirements

A donor would be required to report to the IRS and beneficiaries the basis, character, and other information regarding the transfer of non-cash assets with a value in excess of \$25,000. In addition, for transfers at death of non-cash assets in excess of \$1.3 million and for appreciated property in excess of \$25,000 received by a decedent within three years of death, the executor would be required to report to the IRS and beneficiaries the basis, character, and other information regarding the transfer of such property. Penalties would apply for the failure to report to the IRS and beneficiaries the required information.

B. Additional Tax Incentives

1. Education proposals

(a) Allow teachers to deduct out-of-pocket classroom expenses

The President's budget proposal would allow an above-the-line deduction of up to \$400 for out-of-pocket expenses incurred by full-time schoolteachers (including principals, counselors, teacher's aides, librarians and coaches) at grade levels kindergarten through twelfth grade. Eligible expenses would include books, supplies, and equipment related to classroom instruction that become school property. Additionally, teacher training expenses related to current teaching positions would qualify for the deduction. The proposal would be effective for expenditures made after December 31, 2001.

(b) Allow tax-free distributions from qualified State tuition plans for certain higher education expenses and allow private colleges to offer prepaid tuition plans

The President's budget proposal would allow tax-free distributions from qualified State tuition plans for certain higher education expenses and allow private colleges to offer prepaid tuition plans (but not savings account plans). The definition of "qualified higher education expenses" eligible for the exclusion would be limited to (1) tuition and fees required for enrollment or attendance, (2) expenses for books, supplies, and equipment incurred in connection with such enrollment or attendance, and (3) certain room and board expenses for a student enrolled at least half time. "Qualified higher education expenses" would not include expenses for education involving sports, games, or hobbies, unless the education is part of the student's degree program or is taken to acquire or improve job skills of the individual.

The proposal would allow a qualified tuition program to permit up to three qualified account transfers without violating the prohibition on investment direction and would permit a first cousin of the original beneficiary to be considered a "member of the family" eligible to benefit from a tax-free rollover. The proposal would allow an education tax credit and/or distribution from an education savings account in the same year as a tax-free withdrawal from a qualified tuition program, provided the distribution is not used for the same qualified higher education expenses. The proposal generally would provide a 10-percent additional tax on the earnings portion of any nonqualified withdrawal. A 20-percent additional tax would be imposed on any earnings in excess of \$5,000 on nonqualified withdrawals. Finally, the proposal would provide a cumulative lifetime cap on excludable earnings from all qualified tuition programs with respect to a beneficiary. The cap would be equal to 50 times the maximum grant authorized under the Federal Pell Grant Program.

The proposal would be effective for taxable years beginning after December 31, 2001.

(c) Allow States to issue tax-exempt private activity bonds for school construction

The President's budget proposal would authorize a new category of exempt facility bonds to finance "qualified public educational facilities," which would be owned by a for-profit entity under a public-private partnership agreement with a State or local educational agency. The facilities would have to be operated by a public educational agency as part of a system of public

schools. A separate annual per-State volume limit would apply equal to the greater of \$10 per resident or \$5 million. The proposal would be effective for bonds issued after December 31, 2001.

2. Health and long-term care proposals

(a) Refundable tax credit for the purchase of health insurance

The President's budget proposal would create a refundable income tax credit for health insurance purchased for individuals who are under age 65 and do not participate in a public or employer-provided health plan. Policies eligible for the credit would have to meet certain requirements. The amount of the credit would be 90 percent of premiums up to a maximum of \$1,000 if one individual is covered by the policy or \$2,000 if two or more individuals are covered. The credit would be phased out for an individual taxpayer with no dependents who has adjusted gross income between \$15,000 and \$30,000. For all other taxpayers, the credit would be phased out for adjusted gross income between \$30,000 and \$45,000, if the policy covers one individual, or adjusted gross income between \$30,000 and \$60,000, if the policy covers two or more individuals. The phase-out amounts would be indexed. The credit could be claimed on the individual's tax return or as part of the premium payment process. A phased-in credit of up to \$750 for one covered individual (\$1,500 for two or more individuals) would be available for 2002 and 2003. The full credit would be effective for taxable years beginning after December 31, 2003.

(b) Provide an above-the-line deduction for long-term care insurance premiums

The President's budget proposal would provide an above-the-line deduction to individuals for the amount of premiums paid for qualified long-term care insurance. The proposed deduction would be subject to the present-law dollar limits applicable to the deduction of qualified long-term care insurance premiums as a medical expense. The proposed deduction would apply to the employee's share of premiums for employer-provided long-term care insurance, provided the employee's share is at least 50 percent. The proposal would impose unspecified new standards for qualified long-term care insurance contracts. The proposal would be effective for taxable years beginning after December 31, 2001, subject to a phase-in period. The deduction would be allowed for 25 percent of premiums in 2002, 2003 and 2004, 35 percent in 2005, 65 percent in 2006, and 100 percent for 2007 and thereafter.

(c) Allow up to \$500 in unused benefits in a health flexible spending arrangement to be carried forward to the next year

The President's budget proposal would allow up to \$500 of unused amounts in an employee's health flexible spending arrangement to be carried over to the employee's account in the health flexible spending arrangement for the next year. The proposal would be effective for plan years beginning after December 31, 2001.

(d) Provide additional choice with regard to unused benefits in a health flexible spending arrangement

The President's budget proposal would permit unused amounts of up to \$500 in an employee's health flexible spending arrangement to be distributed to the employee or contributed to a 401(k) or similar plan or to an Archer medical savings account (subject to the normal tax rules for contributions to these arrangements). The proposal would be effective for plan years beginning after December 31, 2001.

(e) Permanently extend and reform Archer medical savings accounts

The President's budget proposal would (1) make Archer medical savings accounts permanent, (2) remove the limit on the number of Archer medical savings accounts that may be established, (3) allow all employees and individuals covered by a high deductible plan to contribute to an Archer medical savings account, (4) modify the definition of high deductible health plan, (5) increase the amount of permissible contributions, and (6) permit contributions to be made through a cafeteria plan. The proposal would be effective for taxable years beginning after December 31, 2001.

(f) Provide an additional personal exemption to home caretakers of family members

The President's budget proposal would allow an additional personal exemption to a taxpayer who maintains a household that includes certain qualified family members. Qualified family members would include any individual with long-term care needs who: (1) is a spouse of the taxpayer, an ancestor of the taxpayer, or the spouse of such an ancestor; and (2) is a member of the taxpayer's household for the entire taxable year. In general, an individual would be considered to have long-term care needs if the individual was certified by a licensed physician as being unable to perform for at least 180 consecutive days at least two activities of daily living without substantial assistance from another individual due to a loss of functional capacity. Activities of daily living would be eating, toileting, transferring, bathing, dressing, and continence. The proposal would be effective for taxable years beginning after December 31, 2001.

(g) Provide tax relief for awards under certain health education programs

The President's budget proposal would exclude from income as a scholarship amounts received under the National Health Service Corps Scholarship Program or the Armed Forces Health Professions Scholarship and Financial Assistance Program. The proposal would be effective for education awards received after December 31, 2001.

3. Exclude from income the value of employer-provided computers, software, and peripherals provided to employees with disabilities

The President's budget proposal would allow an individual with a disability to exclude from income the value of computers, software and other equipment provided by the individual's employer if the equipment is necessary for the individual to perform work for the employer at home and the employee makes substantial use of the equipment to perform work for the employer. The exclusion would apply to all use of the equipment including personal use and use

in a trade or business other than working as an employee of the employer. The proposal would be effective for taxable years beginning after December 31, 2001.

4. Permanently extend and increase the adoption tax credit

The President's budget proposal would make the adoption tax credit permanent for all adoptions. The maximum credit would be increased to \$7,500 (\$8,500 for special needs adoptions). The proposal would be effective after December 31, 2001.

5. Establish Farm, Fish, and Ranch Risk Management (FFARRM) savings accounts

The President's budget proposal would allow taxpayers engaged in an eligible business to establish FFARRM accounts. An eligible business would be any trade or business of farming, ranching, or commercial fishing businesses in which the taxpayer actively participates. Contributions to a FFARRM account would be deductible and would be limited to 20 percent of the taxable income that is attributable to the eligible business. A FFARRM account would be taxed as a grantor trust and any earnings would be required to be distributed currently (and thus taxed currently to the farmer or fisherman who established the account). Amounts may remain on deposit in a FFARRM account for up to five years. Distributions of contributions to FFARRM accounts would be includible in the gross income of the account owner at the time of distribution. Any amount that has not been distributed by the close of the fourth year following the year of deposit would be deemed to be distributed and includible in the gross income of the account owner. The proposal would be effective for taxable years beginning after December 31, 2001.

6. Provide tax credit for developers of affordable single-family housing

The President's budget proposal would create a single-family housing tax credit similar to the present-law low-income rental housing tax credit. Under the proposal, the credit would provide \$1.75 of tax credit authority annually to each State for every resident in the State. The \$1.75 amount would be indexed for inflation. Each State (or local government) would allocate its credit authority to qualified developers or investor partnerships who would claim the credit for the five years after the qualified property is sold to a qualified buyer. The maximum credit for each unit could not exceed the present value of 50 percent of the qualifying costs of that housing unit. Qualified homebuyers would have incomes of 80 percent (70 percent for families with less than three members) or less of area median income. A qualified homebuyer would be subject to recapture if he or she sells to a nonqualified buyer within three years of the initial sale of the qualified unit. The proposal would be effective beginning in calendar year 2002.

7. Establish individual development accounts

The President's budget proposal would create a tax credit to defray the cost to financial institutions of establishing individual development accounts, contributing matching funds to individual development accounts, and providing financial education to account holders. The credit would consist of the following three components: (1) a \$70 per account credit to offset the cost of establishing the account providing basic financial literacy training; (2) a \$30 per account credit per year to offset the ongoing costs to the financial institution of maintaining the account; and (3) a 90-percent credit for up to \$300 contributed to each account annually, for a maximum

annual per account credit of \$270. The \$70 credit would be effective with respect to individual development accounts established between 2003 and 2007. The annual maintenance credit and the credit for annual matching contributions would be effective for years between 2003 and 2009.

8. Environmental and energy proposals

(a) Permanently extend expensing of brownfields remediation costs

The President's budget proposal would make permanent the expensing of qualified brownfields remediation expenditures permitted under section 198, which is scheduled to expire under present law for expenditures after December 31, 2003.

(b) Exclude 50 percent of gains from the sale of property for conservation purposes

The President's budget proposal would provide for an exclusion from income for 50 percent of the gain from the sale of land (or an interest in land or water) sold for a qualified conservation purpose to a governmental unit or a charity that is a qualified conservation organization. The proposal would be effective for sales after the date of first committee action.

(c) Extend and modify the tax credit for producing electricity from certain sources

The President's budget proposal would extend the placed-in-service date for qualifying facilities producing electricity from wind and biomass to facilities placed in service before January 1, 2005. The placed-in-service date for facilities producing electricity from chicken litter would remain facilities placed in service before January 1, 2002. In addition, the proposal would expand the definition of qualifying biomass to include any solid nonhazardous, cellulosic waste material that is segregated from other waste materials and is derived from certain forest related resources, waste pallets, crates and certain other dunnage, and certain agricultural sources. The proposal would permit the credit to be claimed through 2004 at a reduced rate for qualifying facilities that were placed in service prior to 2002 and for facilities that co-fire eligible biomass with coal. The proposal also would modify certain rules relating to leasing and coordination with other government subsidies.

(d) Provide tax credit for residential solar energy systems

The President's budget proposal would allow individuals who purchase photovoltaic equipment or solar water heating equipment for use in their personal residence a nonrefundable credit equal to 15 percent of the cost of the equipment and its installation up to a maximum credit of \$2,000 per residence for photovoltaic equipment and \$2,000 per residence for solar water heating equipment. The credit would apply to solar water heating equipment placed in service after December 31, 2001, and before January 1, 2006. The credit would apply to photovoltaic systems placed in service after December 31, 2001, and before January 1, 2008.

(e) Modify treatment of nuclear decommissioning funds

The President's budget proposal would repeal the cost-of-service requirement for deductible contributions to qualified nuclear decommissioning funds. Thus, taxpayers in States

in which electric generation has been deregulated would be allowed a deduction for amounts contributed to a qualified nuclear decommissioning fund. In addition, the proposal would allow taxpayers to make contributions in excess of the maximum annual contribution amount (as determined by the IRS) up to an amount that equals the present value of the amount required to pay the plant's pre-1984 decommissioning costs. Any amount transferred under the proposal that exceeds the amount previously deducted or excluded from gross income would be allowed as a deduction ratably over the remaining useful life of the nuclear power plant. The proposal also would permit deductible contributions to a qualified fund after the end of the nuclear power plant's estimated useful life and would provide that nuclear decommissioning costs are deductible when paid. The proposal would be effective for taxable years beginning after December 31, 2001.

C. One-Year Extension of Provisions Expiring in 2001

The President's budget proposal would extend for one year the following provisions expiring in 2001:

- (1) The work opportunity tax credit, effective for qualified individuals who begin work for their employer before January 1, 2003.
- (2) The welfare-to-work tax credit, effective for qualified individuals who begin work for their employer before January 1, 2003.
- (3) The exclusion for employer-provided educational assistance, effective through December 31, 2002.
- (4) The provision allowing the nonrefundable personal credits against both regular tax liability and alternative minimum tax liability, through 2002.
- (5) The present-law temporary exceptions from subpart F foreign personal holding company income, foreign base company services income, and insurance income for certain income that is derived in the active conduct of a banking, financing, or similar business, or in the conduct of an insurance business, through 2002.
- (6) The suspension of the 100 percent of net income limitation for percentage depletion, through 2002.
- (7) The authority to issue up to \$400 million of qualified zone academy bonds in calendar year 2002.

D. Disclosure of Return Information for Administration of Certain Veterans' Programs

The President's budget proposal would make permanent the currently temporary statutory authority for the IRS to provide the Department of Veterans Affairs with access to IRS data for purposes of determining eligibility for means-tested veterans benefits.