DESCRIPTION OF S. 2
("AMERICAN FAMILY TAX RELIEF ACT")

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

January 21, 1997

JCX-2-97

CONTENTS

		Page
INTRODUCTION		1
I.	SUMMARY OF S. 2	2
II.	DESCRIPTION OF THE BILL	6
	A. Child Tax Credit for Children Under Age 18 (Title I)	6
	B. Capital Gains Provisions (Title II)	7
	1. 50-percent capital gains deduction for individuals (sec. 201)	7
	2. Indexing of basis of certain assets for purposes of determining gain (sec. 202)	8
	3. Small business stock (sec. 203)	11
	4. 28-percent corporate alternative tax for capital gains (sec. 204)	12
	5. Capital loss deduction on the sale or exchange of a principal residence (sec. 205)	13
	C. Estate and Gift Tax Provisions (Title III)	14
	1. Increase estate and gift tax unified credit (sec. 301)	14
	2. Estate tax exclusion for qualified family-owned businesses (sec. 302)	15
	3. Installment payments of estate tax attributable to closely held businesses (secs. 303-304)	17
	D. IRA Provisions (Title IV)	18
	1. Restoration of IRA deduction for all taxpayers (sec. 401)	18
	2. Deductible IRAs for nonworking spouses (sec. 402)	19
	3. Nondeductible contributions to tax-free IRA Plus accounts (sec. 403)	19
	4. IRA withdrawals for business startup, long-term unemployment, and post-secondary education expenses (secs. 404-406)	21
III.	ESTIMATED REVENUE EFFECTS OF S. 2	23

INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a description of S. 2 ("American Family Tax Relief Act"). S. 2 was introduced on January 21, 1997, by Senators Roth and Lott.

Part I of the document is a summary of the bill. Part II is a description of the provisions of the bill: Title I of the bill provides a child tax credit for children under age 18; Title II relates to capital gains and loss provisions; Title III relates to estate and gift tax provisions; and Title IV relates to individual retirement account ("IRA") provisions.

The document (Part III) also provides estimated revenue effects of the bill for fiscal years 1997-2007.

---

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of S. 2 ("American Family Tax Relief Act")* (JCX-2-97), January 21, 1997.

I. SUMMARY OF S. 2
("American Family Tax Relief Act")

Child tax credit (Title I)

The bill would allow taxpayers a nonrefundable tax credit of $500 for each qualifying child under the age of 18. The credit amount would not be indexed for inflation. For taxpayers with AGI in excess of certain thresholds, the allowable child credit would be reduced by $25 for each $1,000 of AGI (or fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold would be $110,000. For taxpayers filing single or head of household returns, the threshold would be $75,000. For married taxpayers filing separate returns, the threshold would be $55,000. These thresholds are not indexed for inflation. The provision would be effective for taxable years beginning after December 31, 1996.

Capital gains provisions (Title II)

The bill would allow individuals a deduction equal to 50 percent of net capital gain for the taxable year. The bill repeals the present-law maximum 28-percent rate. Thus, the effective rate under the regular tax on the net capital gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket would be 19.8 percent. In addition, the bill would provide an alternative tax of 28 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the adjusted basis of certain assets for purposes of determining gain (but not loss) upon a sale or other disposition of such assets by a taxpayer other than a C corporation. To be eligible for indexing, an asset must be held by the taxpayer for more than three years.

In addition, the bill would make certain modifications related to the present-law exclusion for gain from certain small business stock. The bill would repeal the minimum tax preference applicable to such gain, increase the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million, repeal the limitation on the amount of gain an individual can exclude with respect to the stock of any corporation, modify the working capital requirements, and provide corporate taxpayers an alternative rate of 21 percent on the gain from the sale or exchange of qualified small business stock (other than stock of a subsidiary corporation).

The bill would provide that losses recognized by a taxpayer on the sale of his or her personal residence may be deducted as capital losses rather than be treated as nondeductible personal losses.

The changes generally would be effective for dispositions occurring after December 31, 1996. In the case of the indexing of the basis of assets, the bill would be effective for

dispositions occurring after December 31, 1996, with respect to assets the holding period of which begins after December 31, 1996.

Estate and gift tax provisions (Title III)

Increases in estate and gift tax unified credit

The bill would increase ratably the present-law unified estate and gift tax credit over an 8-year period beginning in 1997, from an effective exemption of $600,000 to an effective exemption of $1,000,000. The full $1,000,000 effective exemption would be available for decedents dying, and gifts made, after December 31, 2003.

Estate tax exclusion for qualified family-owned businesses

The bill would provide special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate. Subject to certain requirements, the bill would exclude the first $1,500,000 in value of qualified family-owned business interests from the decedent's estate and would also exclude 50 percent of the remaining value of qualified family-owned business interests. In general, a qualified family-owned business interest would be any nonpublicly-traded interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if ownership of the trade or business is held at least 50 percent by one family, 70 percent by two families, or 90 percent by three families, as long as the decedent's family owns at least 30 percent of the trade or business. To qualify for the beneficial treatment, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's death, and each qualified heir (or a member of the qualified heir's family) would be required to materially participate in the trade or business for at least five years of each eight-year period ending within ten years after the decedent's death.

The provision would be effective for decedents dying after December 31, 1996.

Installment payments of estate tax attributable to closely held businesses

The bill would extend the period for which Federal estate tax installments could be made under section 6166 to a maximum period of 24 years. If the election were made, the estate would pay only interest for the first four years, followed by up to 20 annual installments of principal and interest. Under the bill, there would be no interest imposed on the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely held business. The interest rate imposed on the amount of deferred estate tax attributable to the value of the closely held business in excess of $1,000,000 would remain as under present law (i.e., the rate applicable to underpayments of tax under section 6621, which is the Federal short-term rate plus 3 percentage points). The provision would be effective for decedents dying after December 31, 1996.

IRA provisions (Title IV)

Restoration of IRA deduction for all taxpayers

The bill would increase the AGI limits applicable to deductible IRA contributions for active participants in 1997, 1998, 1999, and 2000. Thereafter, the bill would repeal the limits on IRA deductions for active participants in employer-sponsored retirement plans. Thus, under the bill, after 2000, an individual would be entitled to make a $2,000 deductible IRA contribution without regard to whether the individual was an active participant in an employer-sponsored retirement plan. The bill would be effective for taxable years beginning after December 31, 1996.

Allow full spousal IRA deduction for nonworking spouses

The bill would permit nonworking spouses to make a full deductible IRA contribution, effective for taxable years beginning after December 31, 1996.

Nondeductible contributions to tax-free IRA Plus accounts

The bill would permit taxpayers to make nondeductible contributions to new IRA Plus accounts. Generally, IRA Plus accounts would be treated in the same manner as and be subject to the same rules applicable to deductible IRAs.

Under the bill, any qualified distribution from an IRA Plus account would not be included in gross income and would not be subject to the 10-percent additional income tax on early withdrawals. A qualified distribution from an IRA Plus account would include any payment or distribution (1) made on or after the date the IRA Plus owner attains age 59-1/2, (2) made to a beneficiary of the IRA Plus owner after death, (3) on account of disability of the IRA Plus owner, or (4) which is a qualified special purpose distribution (i.e., a distribution for medical expenses, the costs of starting a business of the IRA Plus owner or the owner's spouse, long-term unemployment, and higher education expenses).

The bill would permit amounts withdrawn from IRAs to be transferred into an IRA Plus. The amount transferred would be includible in gross income in the year the withdrawal was made, except that amounts transferred to an IRA Plus before January 1, 1999, would be includible in income ratably over a 4-year period. The 10-percent early withdrawal tax would not apply to amounts transferred from an IRA to an IRA Plus account.

The provisions of the bill relating to IRA Plus accounts would be effective for taxable years beginning after December 31, 1996.

Penalty-free IRA withdrawals for starting a business, long-term unemployment, and post-secondary education expenses

The bill would permit penalty-free and tax-free withdrawals from an individual retirement arrangement (IRA) for starting a business of the IRA owner, starting a business of the spouse of the IRA owner, in the case of long-term unemployment of the IRA owner, for any reason, and for the post-secondary education expenses of the IRA owner, the spouse of the IRA owner, or a dependent child of the IRA owner or spouse. The provision would be effective for distributions after December 31, 1996.

II. DESCRIPTION OF THE BILL

A. Child Tax Credit For Children Under Age 18 (Title I)

Present Law

Present law does not provide tax credits based solely on the taxpayer's number of dependent children. Taxpayers with dependent children, however, generally are able to claim a personal exemption for each of these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is $2,650 for 1997, and is adjusted annually for inflation. In 1997, the amount of the personal exemption is phased out for taxpayers with AGI in excess of $121,200 for single taxpayers, $151,500 for heads of household, and $181,800 for married couples filing joint returns. These phaseout thresholds are adjusted annually for inflation.

Description of the Bill

The bill would allow taxpayers a nonrefundable tax credit of $500 for each qualifying child under the age of 18. The credit amount would not be indexed for inflation.

For taxpayers with AGI in excess of certain thresholds, the allowable child credit would be reduced by $25 for each $1,000 of AGI (or fraction thereof) in excess of the threshold. For married taxpayers filing joint returns, the threshold would be $110,000. For taxpayers filing single or head of household returns, the threshold would be $75,000. For married taxpayers filing separate returns, the threshold would be $55,000. These thresholds would not be indexed for inflation.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1996.

B. Capital Gains Provisions (Title II)

1. 50-percent capital gains deduction for individuals (sec. 201 of the bill)

Present Law

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 capital assets, the net capital gain is taxed at the same rate as ordinary income, except that individuals are subject to a maximum marginal rate of 28 percent of the net capital gain. 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 year. Gain or loss is treated as long-term if the asset is held for more than one year.

A capital asset generally means any property except (1) inventory, stock in trade, or property held primarily for sale to customers in the ordinary course of the taxpayer's trade or business, (2) depreciable or real property used in the taxpayer's trade or business, (3) specified literary or artistic property, (4) business accounts or notes receivable, or (5) certain U.S. publications. In addition, the net gain from the disposition of certain property used in the taxpayer's trade or business is treated as long-term capital gain. However, gain is not treated as capital gain to the extent of previous depreciation allowances (in the case of real property, generally only to the extent in excess of the allowances that would have been available under the straight-line method).

Prior to the enactment of the Tax Reform Act of 1986, individuals were allowed a deduction equal to 60 percent of net capital gain. The deduction resulted in a maximum effective tax rate of 20 percent on such gains.

Capital losses are generally deductible in full against capital gains. In addition, individuals may deduct capital losses against up to $3,000 of ordinary income in each year. Capital losses in excess of the amount deductible are carried forward indefinitely. Prior to the Tax Reform Act of 1986, individuals were required to use two dollars of long-term capital loss to offset each dollar of ordinary income.

Description of the Bill

The bill would allow individuals a deduction equal to 50 percent of net capital gain for the taxable year. The bill would repeal the present-law maximum 28-percent rate. Thus, under the bill, the effective rate under the regular tax on the net capital gain of an individual in the highest (i.e., 39.6 percent) marginal rate bracket would be 19.8 percent.

Collectibles would not be allowed the capital gains deduction; instead a maximum rate of 28 percent would apply to the gain of an individual from the sale or exchange of collectibles held for more than one year.

The bill would reinstate the rule in effect prior to the 1986 Tax Reform Act that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income would continue to apply.

Effective Date

The provision would generally apply to taxable years ending after December 31, 1996.

For a taxpayer's taxable year that includes January 1, 1997, the 50-percent capital gains deduction would not apply to any amount properly taken into account before January 1, 1997. In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity would be the appropriate date for applying this rule.

The capital loss rule would apply to taxable years beginning after December 31, 1997, but would not apply to the carryover of capital losses sustained in taxable years beginning before January 1, 1998.

The bill would not affect the capital gains treatment of lump sum distributions grandfathered by the Tax Reform Act of 1986.

2. Indexing of basis of certain assets for purposes of determining gain (sec. 202 of the bill)

Present Law

Under present law, gain or loss from the disposition of any asset generally is the sales price of the asset reduced by the taxpayer's adjusted basis in that asset. The taxpayer's adjusted basis generally is the taxpayer's cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflation.

Description of the Bill

In general

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the adjusted basis of certain assets (called "indexed assets") for purposes of determining gain (but not loss) upon a sale or other disposition of such assets by a taxpayer other than a C corporation. Assets held by trusts, estates, S corporations, regulated investment companies ("RICs"), real estate investment trusts ("REITs"), and partnerships are eligible for indexing, to the extent gain on such assets is taken into account by taxpayers other than C corporations.

Indexed assets

Assets eligible for the inflation adjustment generally would include common (but not preferred) stock of C corporations and tangible property that are capital assets or property used in a trade or business. To be eligible for indexing, an asset must be held by the taxpayer for more than three years.

Computation of inflation adjustment

The inflation adjustment under the provision would be computed by multiplying the taxpayer's adjusted basis in the indexed asset by an inflation adjustment percentage. The inflation adjustment percentage would be the percentage by which the gross domestic product deflator for the last calendar quarter ending before the disposition exceeds the gross domestic product deflator for the last calendar quarter ending before the asset was acquired by the taxpayer. The inflation adjustment percentage would be rounded to the nearest one-tenth of a percent. No adjustment would be made if the inflation adjustment is one or less.

Special entities

RICs and REITs

In the case of a RIC or a REIT, the indexing adjustments generally would apply in computing the taxable income and the earnings and profits of the RIC or REIT. The indexing adjustments, however, would not be applicable in determining whether a corporation qualifies as a RIC or REIT.

In the case of shares held in a RIC or REIT, partial indexing generally would be provided by the provision based on the ratio of the value of indexed assets held by the entity to the value of all its assets. The ratio of indexed assets to total assets would be determined quarterly (for RICs, the quarterly ratio would be based on a three-month average). If the ratio of indexed assets to total assets exceeds 80 percent in any quarter, full indexing of the shares would be allowed for that quarter. If less than 20 percent of the assets are indexed assets in any quarter, no indexing would be allowed for that quarter for the shares. Partnership interests held by a RIC or REIT would be subject to a look-through test for purposes of determining whether, and to what degree, the shares in the RIC or REIT are indexed.

A return of capital distribution by a RIC or REIT generally would be treated by a shareholder as allocable to stock acquired by the shareholder in the order in which the stock was acquired.

Partnership and S corporations, etc.

Under the bill, stock in an S corporation or an interest in a partnership or common trust fund would not be an indexed asset. Under the provision, the individual owner would receive

the benefit of the indexing adjustment when the S corporation, partnership, or common trust fund disposes of indexed assets. Under the provision, any inflation adjustments at the entity level would flow through to the holders and result in a corresponding increase in the basis of the holder's interest in the entity. Where a partnership has a section 754 election in effect, a partner transferring his interest in the partnership would be entitled to any indexing adjustment that has accrued at the partnership level with respect to the partner and the transferee partner is entitled to the benefits of indexing for inflation occurring after the transfer.

The indexing adjustment would be disregarded in determining any loss on the sale of an interest in a partnership, S corporation or common trust fund.

Foreign corporations

Common stock of a foreign corporation generally would be an indexed asset if the stock is regularly traded on an established securities market. Indexed assets, however, would not include stock in a foreign investment company, a passive foreign investment company (including a qualified electing fund), a foreign personal holding company, or, in the hands of a shareholder who meets the requirements of section 1248(a)(2) (generally pertaining to 10-percent shareholders of controlled foreign corporations), any other foreign corporation. An American Depository Receipt (ADR) for common stock in a foreign corporation would be treated as common stock in the foreign corporation and, therefore, the basis in an ADR for common stock generally would be indexed.

Other rules

Improvements and contributions to capital

No indexing would be provided for improvements or contributions to capital if the aggregate amount of the improvements or contributions to capital during the taxable year with respect to the property or stock is less than $1,000. If the aggregate amount of such improvements or contributions to capital is $1,000 or more, each addition would be treated as a separate asset acquired at the close of the taxable year.

Suspension of holding period

No indexing adjustment would be allowed during any period during which there is a substantial diminution of the taxpayer's risk of loss from holding the indexed asset by reason of any transaction entered into by that the taxpayer, or a related party.

Short sales

In the case of a short sale of an indexed asset with a short sale period in excess of three years, the bill would require that the amount realized be indexed for inflation for the short sale period.

Related parties

The bill would not index the basis of property for sales or dispositions between related persons, except to the extent the adjusted basis of property in the hands of the transferee is a substituted basis (e.g., gifts).

Collapsible corporations

Under the bill, indexing would not reduce the amount of ordinary gain that would be recognized in cases where a corporation is treated as a collapsible corporation (under Code sec. 341) with respect to a distribution or sale of stock.

Effective Date

The provision would apply to dispositions of property the holding period of which begins after December 31, 1996. The provision also would apply to a principal residence held by the taxpayer on January 1, 1997 (as if the holding period began on that date). An individual holding any indexed asset (other than a personal residence) on January 1, 1997, may elect to treat the indexed asset as having been sold and reacquired for its fair market value.

3. Small business stock (sec. 203 of the bill)

Present Law

The Revenue Reconciliation Act of 1993 provided individuals a 50-percent exclusion for the sale of certain small business stock acquired at original issue and held for at least five years. One-half of the excluded gain is a minimum tax preference.

The amount of gain eligible for the 50-percent exclusion by an individual with respect to any corporation is the greater of (1) ten times the taxpayer's basis in the stock or (2) $10 million.

In order to qualify as a small business, when the stock is issued, the gross assets of the corporation may not exceed $50 million. The corporation also must meet an active trade or business requirement.

Description of the Bill

Under the bill, the maximum rate of regular tax on the qualifying gain from the sale of small business stock by a taxpayer other than a corporation would remain at 14 percent. The minimum tax preference would be repealed.

The bill would increase the size of an eligible corporation from gross assets of $50 million to gross assets of $100 million. The bill would also repeal the limitation on the amount of gain an individual can exclude with respect to the stock of any corporation.

The bill would provide that certain working capital must be expended within five years (rather than two years) in order to be treated as used in the active conduct of a trade or business. No limit on the percent of the corporation's assets that are working capital would be imposed.

The bill would provide that if the corporation establishes a business purpose for a redemption of its stock, that redemption is disregarded in determining whether other newly issued stock could qualify as eligible stock.

Effective Date

The increase in the size of corporations whose stock is eligible for the exclusion would apply to stock issued after the date of the enactment of the bill. The remaining provisions would apply to stock issued after August 10, 1993 (the original effective date of the small business stock provision).

4. 28-percent corporate alternative tax for capital gains (sec. 204 of the bill)

Present Law

Under present law, the net capital gain of a corporation is taxed at the same rate as ordinary income, and subject to tax at graduated rates up to 35 percent. Prior to the Tax Reform Act of 1986, the net capital gain of a corporation was subject to a maximum effective tax rate of 28 percent.

Description of the Bill

The bill would provide an alternative tax of 28 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

The bill would also provide an alternative rate of 21 percent on the gain from the sale or exchange of qualified small business stock (other than stock of a subsidiary corporation) held more than five years.

Effective Date

The provision would generally apply to taxable years ending after December 31, 1996. For a taxable year which includes January 1, 1997, the 28- percent rate would apply to the lesser of (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1996.

The small business stock provision would apply to stock issued after the date of enactment.

5. Capital loss deduction on the sale or exchange of a principal residence (sec. 205 of the bill)

Present Law

Under present law, the sale or exchange of a principal residence is treated as a nondeductible personal loss.

Description of the Bill

The bill would provide that a loss from the sale or exchange of a principal residence would be treated as a deductible capital loss.

Effective Date

The provision would apply to sales and exchanges after December 31, 1996.

C. Estate and Gift Tax Provisions (Title III)

1. Increase estate and gift tax unified credit (sec. 301 of the bill)

Present Law

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at $192,800, which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased out by a 5-percent surtax imposed upon cumulative taxable transfers over $10 million and not exceeding $21,040,000.[2]

The unified credit was originally enacted in the Tax Reform Act of 1976. The unified credit has not been increased since 1987.

Description of the Bill

The bill would increase the present-law unified credit over an eight-year period beginning in 1997, from an effective exemption of $600,000 to an effective exemption of $1,000,000. The increase would be phased in as follows:

Decedents dying and gifts made in	*Effective exemption*
1997	$650,000
1998	$700,000
1999	$750,000
2000	$800,000
2001	$850,000
2002	$900,000
2003	$950,000
2004 and thereafter	$1,000,000

Conforming amendments to reflect the increased unified credit are made (1) to the general filing requirements for an estate tax return under section 6018(a), and (2) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

Effective Date

The provision would apply to the estates of decedents dying, and gifts made, after

[2] Thus, if a taxpayer has made cumulative taxable transfers exceeding $21,040,000, his or her effective transfer tax rate is 55 percent under present law.

December 31, 1996.

2. Estate tax exclusion for qualified family-owned businesses (sec. 302 of the bill)

Present Law

There are no special estate tax rules for qualified family-owned businesses. All taxpayers are allowed a unified credit in computing the taxpayer's estate and gift tax, which effectively exempts a total of $600,000 in cumulative taxable transfers from the estate and gift tax (sec. 2010). An executor also may elect, under section 2032A, to value certain qualified real property used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value (up to a maximum reduction of $750,000). In addition, an executor may elect to pay the Federal estate tax attributable to a qualified closely-held business in installments over, at most, a 14-year period (sec. 6166). The tax attributable to the first $1,000,000 in value of a closely-held business is eligible for a special 4-percent interest rate (sec. 6601(j)).

Description of the Bill

The bill would provide special estate tax treatment for qualified "family-owned business interests" if such interests comprise more than 50 percent of a decedent's estate. Subject to certain requirements, the bill would exclude the first $1.5 million of value in qualified family-owned business interests from a decedent's estate, and also would exclude 50 percent of the remaining value of qualified family-owned business interests. This new exclusion for qualified family-owned business interests would be provided in addition to the unified credit.

A qualified family-owned business interest would be defined as any interest in a trade or business (regardless of the form in which it is held) with a principal place of business in the United States if one family owns at least 50 percent of the trade or business, two families own 70 percent, or three families own 90 percent, as long as the decedent's family owns at least 30 percent of the trade or business. An interest in a trade or business would not qualify if any interest in the business (or a related entity) was publicly-traded at any time within three years of the decedent's death. An interest in a trade or business also would not qualify if more than 35 percent of the adjusted ordinary gross income of the business for the year of the decedent's death was personal holding company income (as defined in sec. 543). In the case of a trade or business that owns an interest in another trade or business (i.e., "tiered entities"), special look-through rules would apply. The value of a trade or business qualifying as a family-owned business interest would be reduced to the extent the business holds passive assets or excess cash or marketable securities.

To qualify for the beneficial treatment provided under the bill the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, each qualified heir (or a member of the qualified heir's family) would be required to materially participate in the trade or business for at least five years of each eight-year period ending within ten years following the decedent's death.

The benefit of the exclusion for qualified family-owned business interests would be subject to recapture if, within 10 years of the decedent's death and before the qualified heir's death, one of the following "recapture events" occurs: (1) the qualified heir ceases to meet the material participation requirements; (2) the qualified heir disposes of any portion of his or her interest in the family-owned business, other than by a disposition to a member of the qualified heir's family or through a qualified conservation contribution; (3) the principal place of business of the trade or business ceases to be located in the United States; or (4) the qualified heir loses U.S. citizenship.

The portion of the reduction in estate taxes that is recaptured would depend upon the number of years that the qualified heir (or members of the qualified heir's family) materially participated in the trade or business between the date of the decedent's death and the date of the recapture event. If the qualified heir (or his or her family members) materially participated in the trade or business after the decedent's death for less than six years, 100 percent of the reduction in estate taxes attributable to that heir's interest would be recaptured; if the participation was for at least six years but less than seven years, 80 percent of the reduction in estate taxes would be recaptured; if the participation was for at least seven years but less than eight years, 60 percent would be recaptured; if the participation was for at least eight years but less than nine years, 40 percent would be recaptured; and if the participation was for at least nine years but less than ten years, 20 percent of the reduction in estates taxes would be recaptured. In general, there would be no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. As under present-law section 2032A, however, the 10-year recapture period could be extended for a period of up to two years if the qualified heir did not begin to use the property for a period of up to two years after the decedent's death.

In addition, the bill would coordinate the benefit for qualified family-owned business interests with the present-law benefits relating to special-use valuation (sec. 2032A) and the special 4-percent interest rate available for closely-held businesses (sec. 6601(j)). The bill would provide that any amount excluded from a decedent's estate under the qualified family-owned business provision would reduce the ceilings with respect to both section 2032A and section 6601(j). Thus, for example, if a decedent had $100,000 of qualified family-owned business interests, the entire value of his qualified family-owned business property would be excluded from the estate; if the decedent's estate also qualified for treatment under 2032A or 6601(j), the executor could take a maximum reduction under section 2032A of $650,000 (i.e., $750,000 less $100,000), and/or could use the special 4-percent rate provided in section 6601(j) with respect to the Federal estate tax liability attributable to the first $900,000 in value of a qualifying business

(i.e., $1,000,000 less $100,000).

Effective Date

The provision would be effective with respect to the estates of decedents dying after December 31, 1996.

3. Installment payments of estate tax attributable to closely held businesses (secs. 303-304 of the bill)

Present Law

In general, the Federal estate tax is due within nine months of a decedent's death. Under Code section 6166, an executor generally may elect to pay the estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period. If the election is made, the estate may pay only interest for the first four years, followed by up to 10 annual installments of principal and interest. Interest generally is imposed at the rate applicable to underpayments of tax under section 6621 (i.e., the Federal short-term rate plus 3 percentage points). Under section 6601(j), however, a special 4-percent interest rate applies to the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely-held business.

To qualify for the installment payment election, the business must be an active trade or business and the value of the decedent's interest in the closely held business must exceed 35 percent of the decedent's adjusted gross estate. An interest in a closely held business includes: (1) any interest as a proprietor in a business carried on as a proprietorship; (2) any interest in a partnership carrying on a trade or business if the partnership has 15 or fewer partners, or if at least 20 percent of the partnership's assets are included in determining the decedent's gross estate; or (3) stock in a corporation if the corporation has 15 or fewer shareholders, or if at least 20 percent of the value of the voting stock is included in determining the decedent's gross estate.

Description of the Bill

The bill would extend the period for which Federal estate tax installments could be made under section 6166 to a maximum period of 24 years. If the election were made, the estate could pay only interest for the first four years, followed by up to 20 annual installments of principal and interest. Under the bill, there would be no interest imposed on the amount of deferred estate tax attributable to the first $1,000,000 in value of the closely held business. The interest rate imposed on the amount of deferred estate tax attributable to the value of the closely held business in excess of $1,000,000 would remain as under present law (i.e., the Federal short-term rate plus 3 percentage points).

Effective Date

The provision would be effective for decedents dying after December 31, 1996.

D. IRA Provisions (Title IV)

1. Restoration of IRA deduction for all taxpayers (sec. 401 of the bill)

Present Law

Under present law, under certain circumstances, an individual is allowed to deduct contributions up to the lesser of $2,000 or 100 percent of the individual's compensation (or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA, including earnings on contributions, generally are not included in taxable income until withdrawn.

The $2,000 deduction limit is phased out over certain adjusted gross income (AGI) levels if the individual or the individual's spouse is an active participant in an employer-sponsored retirement plan. The phaseout is between $25,000 and $35,000 of AGI for single taxpayers and between $40,000 and $50,000 of AGI for married taxpayers. There is no phaseout of the deduction limit if the individual and the individual's spouse are not active participants in an employer-sponsored retirement plan.

Description of the Bill

The bill would increase the AGI limits applicable to deductible IRA contributions for active participants in 1997, 1998, 1999, and 2000. Thereafter, the bill would repeal the limits on IRA deductions for active participants in employer-sponsored retirement plans. Thus, under the bill, after 2000, an individual would be entitled to make a $2,000 deductible IRA contribution without regard to whether the individual was an active participant in an employer-sponsored retirement plan.

In the case of married taxpayers filing a joint return, for years before 2001, the IRA deduction for active participants would be phased out between the following AGI amounts: for 1997, $65,000 and $75,000; for 1998, $90,000 and $100,000; for 1999, $115,000 and $125,000; and for 2000, $140,000 and $150,000.

In the case of single taxpayers, for years before 2001, the IRA deduction for active participants would be phased out between the following AGI amounts: for 1997, $50,000 and $60,000; for 1998, $75,000 and $85,000; for 1999, $100,000 and $110,000; and for 2000, $125,000 and $135,000.

The bill would provide that the IRA deduction limit for any individual is coordinated with the limit on elective deferrals. Thus, an individual's deductible contributions to an IRA and elective deferrals could not exceed the annual limit on elective deferrals.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1996.

2. Deductible IRAs for nonworking spouses (sec. 402 of the bill)

Present Law

Within limits, an individual is allowed a deduction for contributions to an individual retirement arrangement ("IRA"). An individual generally is not subject to income tax on amounts held in an IRA, including earnings on contributions, until the amounts are withdrawn from the IRA.

The maximum deductible contribution that can be made to an IRA generally is the lesser of $2,000 or 100 percent of an individual's compensation (earned income in the case of a self-employed individual). In the case of a married individual, a deductible contribution of up to $2,000 may be made for each spouse (including, for example, a homemaker who does not work outside the home) if the combined compensation of both spouses is at least equal to the contributed amount.

The maximum permitted IRA deduction is phased out if the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan. The phase-out range is from $25,000 to $35,000 of adjusted gross income for single taxpayers and from $40,000 to $50,000 for married taxpayers filing a joint return.

Description of the Bill

Under the bill, an individual would not be considered an active participant in an employer-sponsored retirement plan merely because the individual's spouse is such an active participant. Thus, the bill would permit a nonworking spouse to make a deductible IRA contribution of up to $2,000 without regard to the present-law income phaseouts.

Effective Date

The provision would be effective for taxable years beginning after December 31, 1996.

3. Nondeductible contributions to tax-free IRA Plus accounts (sec. 403 of the bill)

Present Law

Under present law, under certain circumstances, an individual is allowed to deduct contributions up to the lesser of $2,000 or 100 percent of the individual's compensation (or earned income) to an individual retirement arrangement (IRA). The amounts held in an IRA,

including earnings on contributions, generally are not included in taxable income until withdrawn.

An individual may make nondeductible contributions (up to the $2,000 or 100 percent of compensation limit) to an IRA to the extent the individual is not permitted to make deductible IRA contributions. Nondeductible contributions provide the same tax benefits as deferred annuities, that is, earnings are not includible in income until withdrawn. However, deferred annuities are not subject to contribution limits.

Distributions from IRAs are generally includible in income when withdrawn. Distributions prior to death, disability, or attainment of age 59-1/2 are subject to an additional 10-percent tax. The 10-percent tax does not apply to distributions made in the form of an annuity.

Description of the Bill

The bill would permit taxpayers to make nondeductible contributions to new IRA Plus accounts. Generally, IRA Plus accounts would be treated in the same manner as and be subject to the same rules applicable to deductible IRAs. However, a number of special rules would apply.

Contributions to an IRA Plus would be nondeductible. The amount of nondeductible contributions to an IRA Plus that could be made for any taxable year would be tied to the limits for deductible IRAs, so that the aggregate amount of contributions to an IRA Plus could not exceed the excess of (1) the IRA deduction limit for the year (determined without regard to the rule coordinating the IRA deduction limit with the elective deferral limit) over (2) the amount of IRA contributions actually deducted for the year.

Under the bill, any qualified distribution from an IRA Plus account would not be included in gross income and would not be subject to the 10-percent additional income tax on early withdrawals. A qualified distribution from an IRA Plus account would include any payment or distribution (1) made on or after the date the IRA Plus owner attains age 59-1/2, (2) made to a beneficiary of the IRA Plus owner after death, (3) on account of disability of the IRA Plus owner, or (4) which is a qualified special purpose distribution (i.e., a distribution for medical expenses, the costs of starting a business of the IRA Plus owner or the owner's spouse, long-term unemployment, and higher education expenses).

The bill provides that a distribution would not be treated as a qualified distribution if it is made within the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to an IRA Plus account (or such individual's spouse made a contribution to an IRA Plus account). In addition, the bill provides that a distribution would not be treated as a qualified distribution if, in the case of a distribution attributable to a qualified rollover contribution, the distribution is made within the 5-taxable year period beginning with the taxable year in which the rollover contribution was made.

In the case of a distribution from an IRA Plus account that is not a qualified distribution, in applying the rules of section 72, the distribution would be treated as made from contributions to the IRA Plus account to the extent that such distribution, when added to all previous distributions from the IRA Plus account, does not exceed the aggregate amount of contributions to the IRA Plus account. Thus, nonqualified distributions from an IRA Plus account would not be included in income (and subject to the additional 10-percent tax on early withdrawals) until the IRA owner had withdrawn amounts in excess of all contributions to the IRA Plus account.

Rollover contributions would be permitted to an IRA Plus only to the extent such contributions consist of a payment or distribution from another IRA Plus or from an individual retirement plan. Such rollover contributions would not be taken into account in determining the contribution limit for a taxable year. The normal IRA rollover rules would otherwise govern the eligibility of withdrawals from IRA Plus accounts to be rolled over.

The bill would permit amounts withdrawn from IRAs to be transferred into an IRA Plus. The amount transferred would be includible in gross income in the year the withdrawal was made, except that amounts transferred to an IRA Plus before January 1, 1999, would be includible in income ratably over a 4-year period. The 10-percent early withdrawal tax would not apply to amounts transferred from an IRA to an IRA Plus account.

Under the bill, the excise tax on excess distributions from qualified retirement plans (sec. 4980A) would not apply to distributions from an IRA Plus account or to any qualified rollover contribution from an individual retirement plan to an IRA Plus account.

Effective Date

The provisions of the bill relating to IRA Plus accounts would be effective for taxable years beginning after December 31, 1996.

4. IRA withdrawals for business startup, long-term unemployment, and post-secondary education expenses (secs. 404-406 of the bill)

Present Law

Amounts withdrawn from an individual retirement arrangement ("IRA") are includible in income (except to the extent of any nondeductible contributions). In addition, a 10-percent additional tax applies to withdrawals from IRAs made before age 59-1/2, unless the withdrawal is made on account of death or disability or is made in the form of annuity payments or is made for medical expenses that exceed 7.5 percent of adjusted gross income ("AGI") or is made for medical insurance (without regard to the 7.5 percent of AGI floor) if the individual has received unemployment compensation for at least 12 weeks, and the withdrawal is made in the year such unemployment compensation is received or the following year. If a self-employed individual is not eligible for unemployment compensation under applicable law, then, to the extent provided in regulations, a self-employed individual is treated as having received unemployment

compensation for at least 12 weeks if the individual would have received unemployment compensation but for the fact that the individual was self-employed. The exception to the additional tax ceases to apply if the individual has been reemployed for at least 60 days.

Description of the Bill

The bill would permit withdrawals to be made income tax free and exempt from the 10-percent additional tax if made (1) for the business start-up expenses of the individual or the spouse of the individual; (2) in the event of long-term unemployment, for any reason; or (3) for the post-secondary education expenses of the individual, the spouse of the individual, or a dependent child of the individual or the individual's spouse.

For purposes of this provision, business start-up expenses include expenses associated with the establishment of the business that are incurred on or before the business start date and on or before the date which is one year after the business start date, such as start-up expenditures within the meaning of section 195(c), organizational expenses within the meaning of sections 248(b) and 709(b) and other expenses related to starting a business (e.g., purchasing a computer, software, inventory, etc.). No deduction otherwise allowable with respect to any business start-up expense will be allowed to the extent this provision applies to such expense. In addition, to the extent this provision applies to any portion of business start-up expenses which are properly chargeable to capital account, the basis of the property to which such expenses are chargeable will be reduced by the amount taken into account under this provision.

For purposes of this provision, long-term unemployment has the same meaning as under present law (i.e., the individual has received unemployment compensation for at least 12 weeks).

For purposes of this provision, post-secondary education expenses would be defined as the student's cost of attendance as defined in section 472 of the Higher Education Act of 1965 (generally, tuition, fees, room and board, and related expenses).

Effective Date

The provision would be effective for distributions after December 31, 1996.

III. ESTIMATED REVENUE EFFECTS OF S. 2, THE "AMERICAN FAMILY TAX RELIEF ACT"

Fiscal Years 1997 - 2007

[Billions of Dollars]

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997-02	1997-07
Title I. Child Tax Credit:														
1. $500 tax credit for children under age 18; nonrefundable; $75,000/$110,000 phaseout with no indexing [1]	1/1/97	-4.3	-21.3	-21.3	-21.3	-20.6	-20.2	-19.1	-18.5	-18.0	-17.4	-16.9	-109.0	-198.9
Title II. Capital Gains Provisions:														
(a) 50% deduction for individuals, 2-for-1 loss offset; (b) collectibles get 28% maximum rate; (c) present law section 1250 recapture; (d) allow deduction for individual AMT; (e) indexing starting in 1997 for individuals, with 1/1/97 mark-to-market option; requires 3-year post-96 holding period; (f) small business stock - 14% maximum rate for individuals, reduced corporate rate; and (g) 28% maximum rate for corporations:														
Individual	doa 12/31/96	1.1	12.8	-4.5	-8.9	-12.2	-13.6	-14.9	-16.0	-17.5	-18.6	-20.1	-25.3	-112.4
Corporate	doa 12/31/96	-0.6	-1.3	-1.4	-1.4	-1.5	-1.6	-1.7	-1.7	-1.8	-1.9	-2.0	-7.8	-16.9
Title III. Estate and Gift Provisions:														
1. Increase unified estate and gift tax credit to $1 million by $50,000 per year	1/1/97	---	-0.6	-1.3	-2.0	-2.7	-3.5	-4.4	-5.2	-6.4	-6.8	-7.2	-10.2	-40.1
2. Family-owned business exclusion	dda 12/31/96	---	-1.2	-1.4	-1.6	-1.9	-2.2	-2.7	-3.1	-3.6	-4.0	-4.4	-8.3	-26.0
3. 20-year installment payment where estate consists largely of interest in closely held business	1/1/97	---	---	---	---	---	---	[2]	-0.1	-0.1	-0.1	-0.1	---	-0.4
4. No interest on certain portion of estate tax extended under section 6166	1/1/97	---	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	[2]	-0.1	-0.4

Provision	Effective	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	1997-02	1997-07
Title IV. IRA Provisions:														
1. Eliminate spousal income limits on ability of nonworking spouses to establish deductible IRAs........	tyba 12/31/96	-0.2	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-0.9	-2.8	-6.7
2. Allow penalty-free and tax-free IRA withdrawals for starting own business, starting spouse's business, in the event of long-term unemployment, or for post-secondary education...	1/1/97	-0.3	-0.9	-0.9	-1.0	-1.0	-1.0	-1.1	-1.1	-1.2	-1.3	-1.3	-5.1	-11.1
3. Phase-out income limitation on deductible IRA; create back-end IRAs; and allow rollovers from penalty-free deductible IRAs [3]....................	1/1/97	-0.9	-1.4	-3.3	-4.7	-6.0	-8.4	-10.6	-12.2	-14.1	-16.0	-17.2	-24.8	-94.9
NET TOTALS........		**-5.2**	**-14.3**	**-34.6**	**-41.4**	**-46.5**	**-51.2**	**-55.2**	**-58.6**	**-63.4**	**-66.9**	**-70.1**	**-193.4**	**-507.8**

Source: Joint Committee on Taxation, January 21, 1997.

NOTE: Details may not add to totals due to rounding.

Legend for "Effective" column: dda = decedents dying after
doa = dispositions occurring after
tyba = taxable years beginning after

[1] This credit would affect 48 million dependent children.
[2] Loss of less than $50 million.
[3] Revenue estimate includes interactions with other IRA provisions.