DESCRIPTION OF THE CHAIRMAN'S AMENDMENT IN THE NATURE OF A SUBSTITUTE TO H.R. 6

Scheduled for Markup

before the

HOUSE COMMITTEE ON WAYS AND MEANS

on March 22, 2001

Prepared by

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JOINT COMMITTEE ON TAXATION

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CONTENTS

INTRODUCTION

The House Committee on Ways and Means has scheduled a markup for March 22, 2001, on the provisions of H.R. 6, the Marriage Tax Elimination Act of 2001.

This document,[1] prepared by the staff of the Joint Committee on Taxation, contains a description of present law and the provisions of a Chairman's amendment in the nature of a substitute to the provisions of H.R. 6.

[1] This document may be cited as follows: Joint Committee on Taxation, *Description of the Chairman's Amendment in the Nature of a Substitute to H.R. 6* (JCX-16-01), March 21, 2001.

I. STANDARD DEDUCTION MARRIAGE PENALTY RELIEF

Present Law

Marriage penalty

A married couple generally is treated as one tax unit that must pay tax on the couple's total taxable income. Although married couples may elect to file separate returns, the rate schedules and other provisions are structured so that filing separate returns usually results in a higher tax than filing a joint return. Other rate schedules apply to single persons and to single heads of households.

A "marriage penalty" exists when the combined tax liability of a married couple filing a joint return is greater than the sum of the tax liabilities of each individual computed as if they were not married. A "marriage bonus" exists when the combined tax liability of a married couple filing a joint return is less than the sum of the tax liabilities of each individual computed as if they were not married.

Basic standard deduction

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable),[2] which is subtracted from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is indexed for inflation. For 2001, the size of the basic standard deduction for each filing status is shown in Table 1., below.

[2] Additional standard deductions are allowed with respect to any individual who is elderly (age 65 or over) or blind.

Table 1.--Basic Standard Deduction Amounts

Filing status	Basic standard deduction
Married, joint return..................	$7,600
Head of household return..........	$6,650
Single return.............................	$4,550
Married, separate return............	$3,800

For 2001, the basic standard deduction amount for single filers is 60 percent of the basic standard deduction amount for married couples filing joint returns. Thus, two unmarried individuals have standard deductions whose sum exceeds the standard deduction for a married couple filing a joint return.

Description of Proposal

The proposal would increase the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The basic standard deduction for a married taxpayer filing separately would continue to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately would be the same.

Effective Date

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

II. EXPANSION OF THE 15-PERCENT RATE BRACKET FOR MARRIED COUPLES FILING JOINT RETURNS

Present Law

In general

Under the Federal individual income tax system, an individual who is a citizen or resident of the United States generally is subject to tax on worldwide taxable income. Taxable income is total gross income less certain exclusions, exemptions, and deductions. An individual may claim either a standard deduction or itemized deductions.

An individual's income tax liability is determined by computing his or her regular income tax liability and, if applicable, alternative minimum tax liability.

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income and then is reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

For 2001, the regular income tax rate schedules for individuals are shown in Table 2., below. The bracket breakpoints for single individuals are approximately 60 percent of the rate bracket breakpoints for married couples filing joint returns.[3] The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

[3] The rate bracket breakpoint for the 39.6 percent marginal tax rate is the same for single individuals and married couples filing joint returns.

Table 2.--Individual Regular Income Tax Rates for 2001

If taxable income is:	**Then regular income tax equals**:
	Single individuals
$0-27,050	15 percent of taxable income
$27,050-$65,550	$4,057.50, plus 28% of the amount over $27,050
$65,550-$136,750	$14,837.50, plus 31% of the amount over $65,550
$136,750-$297,350	$36,909.50, plus 36% of the amount over $136,750
Over $297,350	$94,725.50, plus 39.6% of the amount over $297,350
	Heads of households
$0-$36,250	15 percent of taxable income
$36,250-$93,650	$5,437.50, plus 28% of the amount over $36,250
$93,650-$151,650	$21,509.50, plus 31% of the amount over $93,650
$151,650-$297,350	$39,489.50, plus 36% of the amount over $151,650
Over $297,350	$91,941.50, plus 39.6% of the amount over $297,350
	Married individuals filing joint returns
$0-$45,200	15 percent of taxable income
$45,200-$109,250	$6,780.00, plus 28% of the amount over $45,200
$109,250-$166,500	$24,714.50, plus 31% of the amount over $109,250
$166,500-$297,350	$42,461.50, plus 36% of the amount over $166,500
Over $297,350	$89,567.50, plus 39.6% of the amount over $297,350

Alternative minimum tax liability

In general

An individual's alternative minimum tax equals the excess of the individual's tentative alternative minimum tax liability over his or her regular income tax liability. Tentative alternative minimum tax liability is determined by applying specified rates (shown in Table 3., below) to alternative minimum taxable income in excess of phased-out exemption amounts ($45,000 for married couples filing joint returns and $33,750 for unmarried individuals filing a single return). Alternative minimum taxable income generally is the individual's regular taxable income increased by certain preference items and other adjustments. The basic structure of the alternative minimum tax (such as exemption amounts and rate brackets) is not adjusted annually for inflation. The lower regular income tax rates on capital gains also apply under the alternative minimum tax.

Table 3.--Individual Alternative Minimum Tax Rates

If alternative minimum taxable income in excess of the applicable exemption amount is:	**Then tentative alternative minimum tax equals**:
$0-175,000...	26 percent of alternative minimum taxable income in excess of the applicable exemption amount
Over $175,000......................................	$45,500, plus 28% of the amount over $175,000

<u>Limitation on nonrefundable credits</u>

Through 2001, an individual generally may reduce his or her tentative alternative minimum tax liability by nonrefundable personal tax credits (such as the $500 child tax credit and the adoption tax credit). For taxable years beginning after December 31, 2001, nonrefundable personal tax credits may not reduce an individual's income tax liability below his or her tentative alternative minimum tax liability.

<u>AMT offset of refundable tax credits</u>

An individual's alternative minimum tax liability reduces the amount of the refundable earned income credit and, for taxable years beginning after December 31, 2001, the amount of the refundable child credit for families with three or more children.

<u>Description of Proposal</u>

<u>Increase in 15-percent regular income tax bracket</u>

The proposal would increase the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. This increase would be phased in over six years as shown in Table 4., below. Therefore, this provision would be fully effective (i.e., the size of the lowest regular income tax rate bracket for a married couple filing a joint return would be twice the size of the lowest regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2008.

Table 4. -- Increase in Size of 15-Percent Rate Bracket for Married Couples Filing a Joint Return

Taxable year	Size of 15-percent rate bracket for married couple filing joint return as percentage of rate bracket for unmarried individuals
2004	172
2005	178
2006	183
2007	189
2008	195
2009 and thereafter	200

AMT relief

The AMT exemption amount ($45,000) for a married couple filing a joint return would be increased by $1,000 in 2005, by an additional $500 in 2006, and by an additional $500 in every other year thereafter (i.e., in 2008, 2010, etc.), but in no event would the exemption amount exceed twice the exemption amount for unmarried individuals filing single returns. The exemption amount for married individuals filing a separate return would be one-half the exemption amount for a married couple filing a joint return.

The proposal also would repeal the present-law provision that offsets the refundable child credit and the earned income credit by the amount of the alternative minimum tax.

Effective Date

The increase in the size of the 15-percent rate bracket would be effective for taxable years beginning after December 31, 2003. The increase in the AMT exemption would be effective for taxable years beginning after December 31, 2004. Finally, the proposal to repeal the AMT offset for the refundable child credit and the earned income credit would be effective for taxable years after December 31, 2001.

III. MARRIAGE PENALTY RELIEF AND SIMPLIFICATION RELATING TO THE EARNED INCOME CREDIT

Present Law

Eligible low-income workers are able to claim a refundable earned income credit ("EIC"). The amount of the credit an eligible taxpayer may claim depends upon the taxpayer's income and whether the taxpayer has one, more than one, or no qualifying children.

Definition of earned income

To claim the EIC, the taxpayer must have earned income. Earned income consists of wages, salaries, other employee compensation, and net earnings from self-employment. Employee compensation includes anything of value received by the taxpayer from the employer in return for services of the employee, including nontaxable earned income. Nontaxable forms of compensation treated as earned income for EIC purposes include the following: (1) elective deferrals under a cash or deferred arrangement or section 403(b) annuity (sec. 402(g)); (2) employer contributions for nontaxable fringe benefits, including contributions for accident and health insurance (sec. 106), dependent care (sec. 129), adoption assistance (sec. 137), educational assistance (sec. 127), and miscellaneous fringe benefits (sec. 132); (3) salary reduction contributions under a cafeteria plan (sec. 125); (4) meals and lodging provided for the convenience of the employer (sec. 119), and (5) housing allowance or rental value of a parsonage for the clergy (sec. 107). Some of these items are not required to be reported on the Wage and Tax Statement (Form W-2), making it difficult for the taxpayer to ascertain the correct amount of nontaxable earned income.

Calculation of the credit

The maximum EIC is phased in as an individual's earned income increases. The credit phases out for individuals with earned income (or if greater, modified AGI) over certain levels. In the case of a married individual who files a joint return, the EIC both for the phasein and phaseout is calculated based on the couples' combined income. The EIC is not available to married taxpayers filing separate returns.

The credit is determined by multiplying the credit rate by the taxpayer's earned income up to a specified earned income amount. The maximum amount of the credit is the product of the credit rate and the earned income amount. The maximum credit amount applies to taxpayers with (1) earnings at or above the earned income amount and (2) modified AGI[4] (or earnings, if greater) at or below the phaseout threshold level.

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[4] "Modified AGI" means AGI determined without regard to certain losses and increased by certain amounts not includible in gross income. The losses disregarded are: (1) net capital losses (up to $3,000); (2) net losses from estates and trusts; (3) net losses from nonbusiness rents and royalties; (4) 75 percent of the net losses from businesses, computed separately with respect to sole proprietorships (other than farming), farming sole proprietorships, and other businesses. For purposes of (4), amounts attributable to a business that consists of the performance of

For taxpayers with modified AGI (or earned income, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or modified AGI, if greater) in excess of the phaseout threshold. In other words, the credit amount is reduced, falling to $0 at the "breakeven" income level, the point where a specified percentage of "excess" income above the phaseout threshold offsets exactly the maximum amount of the credit. The earned income amount and the phaseout threshold are indexed for inflation. Table 5., below, shows the EIC parameters for taxable year 2001.[5]

Table 5.--Earned Income Credit Parameters (2001)

	Two or more qualifying children	**One qualifying child**	**No qualifying children**
Credit rate (percent)	40.00%	34.00%	7.65%
Earned income amount	$10,020	$7,130	$4,760
Maximum credit	$4,008	$2,424	$364
Phase out begins	$13,090	$13,090	$5,950
Phase out rate (percent)	21.06%	15.98%	7.65%
Phase out ends	$32,121	$28,281	$10,710

Description of Proposal

For married taxpayers who file a joint return, the proposal would increase the earned income amount used to calculate the EIC to 110 percent of the earned income amount for all other taxpayers eligible for the EIC.

The proposal also would simplify the definition of earned income by excluding nontaxable earned income amounts from the definition of earned income for EIC purposes. Thus, under the proposal, earned income would include wages, salaries, tips, and other employee compensation, if includible in gross income for the taxable year, plus net earnings from self-employment.

The proposal would repeal the present-law provision that reduces the EIC by the amount of an individual's alternative minimum tax.

Effective Date

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

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services by the taxpayer as an employee are not taken into account. The amounts added to AGI to arrive at modified AGI include: (1) tax-exempt interest; and (2) nontaxable distributions from pensions, annuities, and individual retirement plans (but not nontaxable rollover distributions or trustee-to-trustee transfers). Sec. 32(c)(5).

[5] The table is based on Rev. Proc. 2001-13.

IV. INCREASE AND EXPANSION OF THE CHILD TAX CREDIT

Present Law

Under present law, an individual may claim a $500 tax credit for each qualifying child under the age of 17. In general, a qualifying child is an individual for whom the taxpayer can claim a dependency exemption and who is the taxpayer's son or daughter (or descendent of either), stepson or stepdaughter, or eligible foster child.

The child tax credit is phased out for individuals with income over certain thresholds. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified AGI over $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. Modified AGI is the taxpayer's total gross income plus certain amounts excluded from gross income (i.e., excluded income of U.S. citizens or residents living abroad (sec. 911); residents of Guam, American Samoa, and the Northern Mariana Islands (sec. 931); and residents of Puerto Rico (sec. 933)). The length of the phase-out range depends on the number of qualifying children. For example, the phase-out range for a single individual with one qualifying child is between $75,000 and $85,000 of modified AGI. The phase-out range for a single individual with two qualifying children is between $75,000 and $95,000.

The child tax credit is not adjusted annually for inflation.

In general, the child tax credit is nonrefundable. However, for families with three or more qualifying children, the child tax credit is refundable up to the amount by which the taxpayer's employee share of social security taxes (i.e., FICA and HI taxes)[6] exceeds the taxpayer's EIC.

Through 2001, the child tax credit generally reduces the individual's regular income tax and alternative minimum tax. Starting with taxable years beginning after December 31, 2001, the nonrefundable child tax credit is allowed only to the extent that the individual's regular income tax liability exceeds the individual's tentative alternative minimum tax, and the refundable child tax credit is reduced by the amount of the individual's alternative minimum tax.

Description of Proposal

The proposal would increase the child tax credit to $1,000, phased in over six years, beginning in 2001. Table 6., below, shows the proposed increase in the amount of the child tax credit under the proposal.

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[6] In the case of self-employed individuals, the credit is refundable up to the amount by which one-half of the individual's self-employment taxes (i.e., SECA taxes) exceedsthe taxpayer's EIC.

Table 6.--Proposed Increase of the Child Tax Credit

Taxable Year	Credit Amount Per Child
2001	$600
2002	$600
2003	$700
2004	$800
2005	$900
2006 and thereafter	$1,000

In addition, the proposal would extend the present-law refundability of the child tax credit to families with fewer than three children.

The proposal would allow the child tax credit to the extent of the full amount of the individual's regular income tax and alternative minimum tax and the refundable child tax credit would no longer be reduced by the amount of the alternative minimum tax.

Effective Date

The proposal would generally be effective for taxable years beginning after December 31, 2000.

V. TRANSFER TO SOCIAL SECURITY AND MEDICARE TRUST FUNDS

Present Law

Under present law, the tax collected under section 86 with respect to a portion of social security benefits included in gross income is transferred either to the Social Security trust fund or the Medicare trust fund.

Description of Proposal

Under the proposal, the amounts transferred to the Social Security and Medicare trust funds are determined as if the other proposals in the bill were not enacted. Thus, there would be no reduction in transfers to these funds as a result of these proposals.

Effective Date

The proposal would be effective on the date of enactment.