OVERVIEW OF PRESENT LAW AND ISSUES RELATING TO INDIVIDUAL INCOME TAXES

Scheduled for a Public Hearing

Before the

SENATE COMMITTEE ON FINANCE

on April 15, 1999

Prepared by the Staff

of the

JOINT COMMITTEE ON TAXATION

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INTRODUCTION

The Senate Committee on Finance has scheduled a public hearing on April 15, 1999, on the complexity of the individual income tax. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides an overview of present law and issues relating to the Federal individual income tax.

Part I of the document is an overview. Part II provides a summary of present-law Federal individual income tax provisions and background information. Part III discusses general sources of complexity for individuals under the Federal income tax laws, and specific provisions giving rise to complexity.

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[1] This document may be cited as follows: Joint Committee on Taxation, *Overview of Present Law and Issues Relating to Individual Income Taxes* (JCX-18-99), April 14, 1999.

I. OVERVIEW

The current U.S. Federal tax system

The current Federal income tax system consists primarily of the regular income tax imposed on the income of individuals and corporations. An individual's income tax liability is determined by applying a graduated rate schedule to the individual's worldwide taxable income and adjusting for applicable tax credits

In the case of individuals, the rate of tax depends on the individual's filing status (i.e., single, head of household, married filing a joint return, and married filing a separate return) and the individual's taxable income. Generally, the individual's taxable income is gross income (determined with respect to applicable deferrals and exclusions) less personal exemptions and the greater of (1) itemized deductions or (2) the standard deduction.

For each filing status, the rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's taxable income increases. The present-law marginal tax rates are 15 percent, 28 percent, 31 percent, 36 percent and, 39.6 percent. Long-term capital gains generally are subject to a maximum rate of 20 percent. The individual may use various income tax credits to reduce the regular income tax liability. An individual is subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent that it exceeds the taxpayer's regular income tax liability.

Part II., below, provides a more detailed overview of the present-law Federal tax system as it applies to individuals.

Need for simplification

Most commentators agree that (1) a tax system should be easy both for individuals to understand and for the government to administer, and (2) the computation of tax liabilities for most taxpayers should not require tedious or time consuming computations or recordkeeping. A complicated tax system may result in inefficiencies because of high compliance costs, as well as a perception of unfairness because of the likelihood that similarly situated taxpayers will have different tax liabilities. A complicated tax system may also result in similarly situated taxpayers reporting unequal tax liabilities because of differing abilities to understand the rules or pay for professional tax assistance.

On the other hand, simplicity in a tax system may involve sacrifices of equity and efficiency. Rules that are complicated may result in more appropriate calculations of tax liability.

General sources of complexity

Certain general sources of complexity in the present-law tax system can be identified. These sources of complexity stem from (1) elections provided to taxpayers, (2) definitional issues that taxpayers must consider, (3) recordkeeping and reporting requirements, (4) limitations on the availability of tax benefits, and (5) frequent changes in the tax laws.

In addition, certain specific provisions of present law may lead to increased complexity for individuals. These provisions include the individual alternative minimum tax, provisions relating to capital gains and losses, various income phase-outs, phase-ins, and floors, provisions relating to individual retirement arrangements ("IRAs"), education tax incentives, the earned income tax credit, the definition of a dependent for Federal tax purposes, and the estimated tax provisions. A detailed discussion of how these provisions increase complexity for individuals is contained in Part III., below.

II. PRESENT LAW AND BACKGROUND

A. Individual Income Taxes

1. Sources of income

The current Federal income tax system consists primarily of income taxes imposed on the income of individuals and corporations. A United States citizen or resident alien generally is subject to the U.S. individual income tax on his or her worldwide taxable income.[2] Taxable income equals the taxpayer's total gross income less certain exclusions, exemptions, and deductions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her individual income tax liability. A taxpayer may reduce his or her income tax liability by any applicable tax credits.

Under the Internal Revenue Code of 1986 (the "Code"), gross income means "income from whatever source derived" except for certain items specifically exempt or excluded by statute.[3] Sources of income include compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income from the discharge of indebtedness, income in respect of a decedent, and income from S corporations, partnerships, trusts or estates. As described in detail below, statutory exclusions from gross income include death benefits payable under a life insurance contract, interest on certain State and local bonds, employer-provided health insurance, employer-provided pension contributions, and certain other employer-provided fringe benefits.

The gross income of most individuals is derived from underlying trade or business activities.[4] Individual gross income may take the form of income from labor (e.g., salaries, wages, and retirement benefits), income from passive investments in businesses (e.g., interest, dividends, and capital gains), or income of business activities that are reported directly by the individual (e.g., rents and royalties, gross profits from sole proprietorships, and income from pass-through entities).

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[2] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income.

A nonresident alien generally is subject to the U.S. individual income tax (at a 30-percent rate) only on income derived from sources within the United States and income that is effectively connected with the conduct of a trade or business within the United States.

[3] Code section 61.

[4] Exceptions are amounts received from governmental or charitable organizations.

Some income derived from trade or business activities is subject to one level of tax, while other such income is subject to two levels of tax. For Federal income tax purposes, a corporation generally is treated as a separate taxpayer apart from its shareholders. Any net income earned by the corporation is subject to the corporate income tax.[5] In determining its taxable income, a corporation generally is allowed deductions for its ordinary and necessary business expenditures. Thus, amounts paid to independent contractors and employees for services and to creditors as interest are subject to one level of tax because such amounts are deductible by the payor corporation, and are includible in the incomes of the recipient service providers or creditors. Conversely, distributions from a corporation with respect to its stock (either as dividends or in liquidation) are subject to two levels of tax because such amounts are not deductible by the corporation, but are includible in the income of the individual shareholders. Some entities (i.e., partnerships, S corporations,[6] and certain trusts, collectively known as "pass-through entities"), on the other hand, generally are not subject to an entity-level tax.[7] Instead, income earned by pass-through entities, whether distributed or not, is taxed directly to the owners in proportion to their interests in the entities, and distributions from the entities generally are tax free.[8] Similarly, income earned by a sole proprietorship is taxed directly to the individual owner.

Figure 1, below, shows sources of income that are subject to tax for all individuals. The major source of individuals' income subject to tax is wages and salaries, which constitute nearly 73 percent of all such income. The next most significant sources of income for individuals are business and farm income (including income reported on Schedule E), which constitute just over 7 percent, and taxable amounts from pensions and individual retirement arrangements ("IRAs"), which constitute just under 7 percent of such income.

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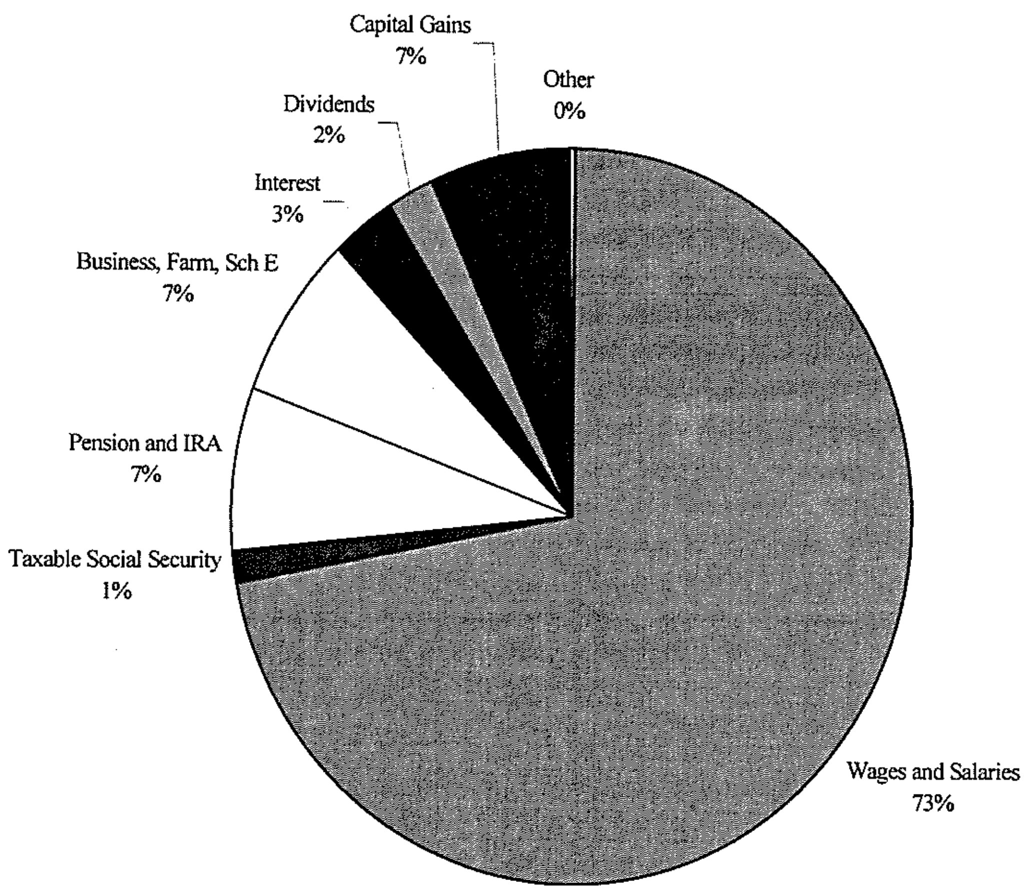
[5] Code section 11. Such corporations generally are referred to as "C corporations" because the tax rules governing the relationship between such corporations and their shareholders are found in subchapter C of the Code.

[6] A small business corporation and its shareholders may elect to be treated in a manner similar to the treatment of a partnership and its partners. Such corporations generally are referred to as "S corporations" because the tax rules governing the treatment of such entities are found in subchapter S of the Code.

[7] In addition, a single level of tax is accorded to certain investment vehicles (such as regulated investment companies, real estate investment trusts, real estate mortgage investment conduits, and financial asset securitization investment trusts) under various statutory regimes.

[8] Losses and tax credits from a pass-through entity generally may not be claimed by an individual unless the individual is "at risk" with respect to, and "materially participates" in, the activities of the entity (secs. 465 and 469).

Figure 1.--Sources of Gross Income Subject to Tax for All Individual Taxpayers (Including Nonfilers and Estimated 1999 Levels of Income) (Millions)



Source: Staff of the Joint Committee on Taxation.

2. Exclusions from and deferrals of income

a. Exclusions from income

i. In general

Present law provides specific exclusions from gross income for certain items of income. Exclusions from income are frequently provided for nontax policy reasons, such as to encourage particular behavior or in situations in which income inclusion has been determined to be inappropriate. For example, the exclusion from income for employer-provided health care is provided in order to encourage employers to provide health insurance for their employees and to encourage employees to prefer to receive some part of their compensation in the form of health insurance. Some exclusions are also provided for administrative reasons. For example, property or services provided by an employer are excludable from gross income as a de minimis fringe benefit if the value is so small as to make accounting for it unreasonable or administrably impracticable.

The benefit of an exclusion from income increases as the taxpayer's marginal tax rate increases. That is, the higher an individual's marginal tax rate, the more the individual saves in taxes by reason of an exclusion. In the case of items that are excludable from wages for employment tax purposes, the individual benefits from reduced employment taxes. However, the individual may also have reduced social security benefits in the future as a result of the exclusion.

Certain of the exclusions from income under present law are described in brief below.

ii. Employer-provided fringe benefits

<u>Employer-provided accident or health care</u>.--Contributions for and amounts received under employer-provided accident or health plans (including plans providing long-term care services or insurance) and employer contributions to medical savings accounts generally are excludable from gross income and from wages for employment tax purposes. The exclusion is limited in the case of a self-insured medical reimbursement plan which discriminates in favor of highly compensated employees.

<u>Educational assistance</u>.--Up to $5,250 annually of employer-provided educational assistance is excludable from gross income and wages, if the assistance is provided pursuant to a separate written plan of an employer that does not discriminate in favor of highly compensated employees and certain other requirements are satisfied. The exclusion does not apply to graduate-level courses. The exclusion does not apply to courses beginning after May 31, 2000.

In the absence of the exclusion, employer-provided educational assistance is excludable from gross income and wages only if the educational assistance relates to the employee's current job.

Dependent care assistance.--Up to $5,000 annually of employer-provided dependent care assistance is excludable from gross income and wages if the assistance is provided pursuant to a separate written plan of an employer that does not discriminate in favor of highly compensated employees and meets certain other requirements. The amount excludable cannot exceed the earned income of the employee or, if the employee is married, the lesser of the earned income of the employee or the earned income of the employee's spouse.

Adoption assistance.--Up to $5,000 per child ($6,000 in the case of a child with special needs) of employer-provided adoption assistance is excludable from gross income. The exclusion does not apply for employment tax purposes. The exclusion is phased out between $75,000 and $115,000 of modified adjusted gross income. This exclusion expires with respect to amounts paid or expenses incurred after December 31, 2001.

Group-term life insurance.--Gross income and wages do not include the cost of up to $50,000 of group-term life insurance provided by the employer. The exclusion is limited in the case of a group-term life insurance plan that discriminates in favor of key employees.

Miscellaneous employee fringe benefits.--The following miscellaneous fringe benefits are excludable from income and wages if certain requirements are satisfied: (1) services provided at no additional cost to the employer (e.g., free flights to airline personnel); (2) qualified employee discounts; (3) working condition fringe benefits (i.e., items that would be deductible as a business expense if the individual paid for the item); and (4) de minimis fringe benefits. In addition, up to $65 per month (for 1999) of van pooling or transit passes provided by the employer and up to $175 per month (for 1999) of qualified parking are excludable from income and wages. Amounts paid by an employer for moving expenses that would be deductible by the employee are excludable from income (if the employee did not deduct the expenses). The value of the use of certain on-premises gyms and other athletic facilities is excludable from income and wages.

The value of meals or lodging furnished to an employee and his or her spouse or dependents for the convenience of the employer are excludable from income and wages. In the case of meals, the meal must be furnished on the business premises of the employer in order for the exclusion to apply. The exclusion for lodging generally does not apply unless the employee is required to accept the lodging on the business premises of the employer as a condition of employment.

Cafeteria plans.--Under present law, compensation generally is includible in gross income in the year in which it is actually or constructively received. An amount is constructively received if it is made available to the taxpayer. Under one exception to the constructive receipt rules, no amount is includible in the gross income of a participant in a cafeteria plan meeting certain requirements merely because the participant can chose between cash and certain nontaxable benefits (such as health care). This exception generally also applies for purposes of employment taxes. If the individual elects to take cash rather than benefits, then the amount of cash received is includible in income and wages.

The constructive receipt exception is not available if the individual is permitted to change a benefit election during a period of coverage in the absence of a change in family status or certain other events. Furthermore, the constructive receipt exception is limited if the cafeteria plan discriminates in favor of highly compensated employees or if the nontaxable benefits provided to key employees exceed a certain percentage of the benefits provided for all employees under the plan.

A similar exception to the constructive receipt doctrine applies if an employee is offered a choice between cash and nontaxable parking, vanpooling, a transit benefit.

iii. Qualified scholarships

Gross income does not include amounts received as a qualified scholarship by an individual who is a candidate for a degree at a qualified education institution or tuition reduction provided to an employee of an educational institution for education below the graduate level. Neither exclusion applies to amounts that are compensation for services required as a condition of receiving the scholarship or tuition reduction, nor does the exclusion apply to amounts attributable to room and board.

iv. Exclusion of Social Security benefits

Under present law, taxpayers receiving Social Security benefits are not required to include any portion of such benefits in gross income if their "provisional income" does not exceed $25,000, in the case of unmarried taxpayers, or $32,000, in the case of married taxpayers filing joint returns. For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income plus: (1) tax-exempt interest; (2) only excludable interest on educational savings bonds; (3) adoption assistance payments; (4) certain deductible student loan interest; (5) certain foreign source income; (6) certain U.S. possession income; (7) certain income from Puerto Rico; and (8) one-half of the taxpayer's Social Security benefits. A second-tier threshold for provisional income is $34,000, in the case of unmarried taxpayers, or $44,000, in the case of married taxpayers filing joint returns.

If the taxpayer's provisional income exceeds the lower threshold but does not exceed the second-tier threshold, then the amount required to be included in income is the lesser of (1) 50 percent of the taxpayer's Social Security benefits, or (2) 50 percent of the excess of the taxpayer's provisional income over the lower threshold.

If the amount of provisional income exceeds the second-tier threshold, then the amount required to be included in income is the lesser of: (1) 85 percent of the taxpayer's Social Security benefits; or (2) the sum of (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold, plus (b) the smaller of (i) the amount of benefits that would have been included if the 50-percent inclusion rule (the rule in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and lower threshold.

Table 1 shows the number of taxpayers receiving Social Security benefits and number of taxpayers subject to tax on a portion of their Social Security benefits.

Table 1.--Distribution of Taxpayers By Income Who Receive Social Security Benefits and Who are in the Phase-In Range for Taxation of Benefits [Calendar Year 1999]

Income category[1]	Taxpayers with Social Security income (millions)	Taxpayers in Social Security phase-in range (millions)
Less than $10,000	2.5	0.0
$10,000 to $20,000	10.1	0.0
$20,000 to $30,000	5.4	(2)
$30,000 to $40,000	4.2	0.9
$40,000 to $50,000	3.3	1.3
$50,000 to $75,000	4.7	2.6
$75,000 to $100,000	1.9	0.2
$100,000 to $200,000	1.5	(2)
$200,000 and over	0.4	0.0
Total, all taxpayers:	34.0	5.0

Details may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

v. Life insurance and accelerated death benefits

Under present law, the investment income ("inside buildup") earned on premiums credited under a life insurance contract is not subject to current taxation. Amounts received under a life insurance contract by reason of the death of the insured or with respect to an insured who is terminally ill or chronically ill are excludable from income. Thus, neither the policyholder nor the policyholder's beneficiary is ever taxed on the inside buildup if the proceeds of the policy are paid to the policyholder's beneficiary by reason of the death of the insured or of the insured being terminally or chronically ill.[9]

vi. Gifts and inheritances

Gross income does not include the value of property acquired by gift, bequest, devise, or inheritance. The value of items so acquired may, however, be subject to the estate and gift tax.

vii. Military benefits

Gross income does not include certain benefits provided to members of the armed forces and their families.

viii. Education savings bonds

Gross income does not include interest earned on an education savings bond to the extent used to pay qualified higher education expenses. For 1999, the exclusion is phased out for individuals with modified adjusted gross income between $53,100 and $68,100 in the case of a single taxpayer and $79,650 and $109,650 in the case of a married taxpayer filing a joint return.

ix. Compensation for personal injuries or sickness

Gross income does not include amounts received under workmen's compensation acts as compensation for personal injuries or sickness. In addition, gross income does not include amounts received as damages (other than punitive damages) on account of personal physical injuries or physical sickness.

x. Step-up of basis at death

Under present law, gain is generally recognized on the sale or exchange of property to the extent the amount received exceeds the individual's basis. In general, the basis is the individual's cost of acquiring the property. In the case of property acquired from a decedent, the basis of the

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[9] In the case of payments with respect to a chronically ill individual, the exclusion may be limited in certain circumstances.

property to the individual receiving the property is generally equal to the fair market value of the property on the date of the decedent's death (i.e., there is a "stepped-up basis"). The effect of the stepped-up basis is to provide an exclusion for the amount of gain that would have been recognized had the property been sold on the date of the decedent's death.

xi. U.S. citizens living abroad

U.S. citizens generally are subject to U.S. income tax on all their income, whether derived in the United States or elsewhere. A U.S. citizen who earns income in a foreign country also may be taxed on such income by that foreign country. However, the United States generally cedes the primary right to tax income derived by a U.S. citizen from sources outside the United States to the foreign country where such income is derived. Accordingly, a credit against the U.S. income tax imposed on foreign source taxable income is provided for foreign taxes paid on that income.

U.S. citizens living abroad may be eligible to exclude from their income for U.S. tax purposes certain foreign earned income and foreign housing costs. In order to qualify for these exclusions, a U.S. citizen must be either (1) a bona fide resident of a foreign country for an uninterrupted period that includes an entire taxable year or (2) present overseas for 330 days out of any 12 consecutive month period. In addition, the taxpayer must have his or her tax home in a foreign country.

The exclusion for foreign earned income generally applies to income earned from sources outside the United States as compensation for personal services actually rendered by the taxpayer. The maximum exclusion for foreign earned income for a taxable year is $74,000 (in 1999).

The exclusion for housing costs applies to reasonable expenses, other than deductible interest and taxes, paid or incurred by or on behalf of the taxpayer for housing for the taxpayer and his or her spouse and dependents in a foreign country. The exclusion amount for housing costs for a taxable year is equal to the excess of such housing costs for the taxable year over an amount computed pursuant to a specified formula. In the case of housing costs that are not paid or reimbursed by the taxpayer's employer, the amount that would be excludible is treated instead as a deduction.

The combined earned income exclusion and housing cost exclusion may not exceed the taxpayer's total foreign earned income. The taxpayer's foreign tax credit is reduced by the amount of such credit that is attributable to excluded income.

Special exclusions apply in the case of taxpayers who reside in one of the U.S. possessions.

xii. Tax-exempt interest

Interest on certain debt obligations of States, territories, and possessions of the United States is exempt from the regular individual.[10] Interest on debt of local governments generally receives identical treatment to that provided for States. Interest on these "State and local government bonds" may, in certain cases, be includible in calculating the individual alternative minimum tax.[11] Additionally, State and local government bond interest is included in determining whether a portion of Social Security benefits is taxable under the regular individual income tax.

The State and local government bond interest exemption applies to two principal types of bonds. First, interest is tax-exempt on bonds issued to finance public activities conducted and paid for by State and local governments themselves ("governmental bonds"). Examples of activities financed with governmental bonds are schools, courthouses, roads, public mass transit systems, and governmentally owned and operated water, sewer, and electric facilities.[12] States and local governments also may issue limited amounts of tax-exempt working capital debt to cover cash-flow shortfalls pending receipt of tax or other revenues ("TRANS"). Further, for Federal income tax purposes, interest paid by these governments under installment sales contracts and finance leases is treated as bond interest.

The second major category of State and local government bonds on which interest is tax-exempt consists of bonds issued by these governmental units acting as a conduit to provide financing for private persons ("private activity bonds"). Unlike governmental bonds, tax-exempt private activity bonds generally may only be issued for purposes specified in the Code. The specified purposes generally relate to privately operated transportation facilities, privately provided municipal services, economic development, and certain social programs. The typical private activity bond issue involves a State or local government as a nominal borrower, with the

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[10] Interest on the Federal Government's debt is taxable, but repayment is guaranteed by the United States. With the exception of State and local government bonds guaranteed under certain grandfathered programs that were in existence before 1985, interest on State and local government bonds is not permitted to be both tax-exempt and Federally guaranteed.

[11] Interest on private activity bonds is a preference item in calculating the individual alternative minimum tax.

[12] State and local government bonds used to finance the acquisition of existing output (e.g., electric utility) property are treated as private activity bonds even if the property is to be governmentally owned and operated, unless (1) the same service was provided to the area to be served by the acquiring governmental entity during the 10-year period before the acquisition, or (2) the area to be served is contiguous to the annexing governmental unit, does not exceed 10 percent of the service area of the acquirer, and is annexed in a qualifying annexation.

funds being simultaneously relent to the ultimate private borrower. Repayment of most private activity bonds comes exclusively from the ultimate private borrower; bond documents may state that there is neither a legal nor a moral obligation of the issuing governmental unit to repay the bonds.

Private activity bonds are classified into several major categories: exempt-facility bonds; qualified redevelopment bonds; qualified small-issue bonds; mortgage revenue bonds; qualified student loan bonds; bonds for charitable organizations exempt from tax under Code section 501(c)(3), and bonds for businesses located in Federal empowerment zones and enterprise communities. Because these bonds provide financing for private business or personal activities, are repaid or secured by private funds, and would not otherwise be subject to Federal restrictions, the Code includes detailed targeting provisions. Further, issuance of most private activity bonds is subject to annual State volume limitations.

xiii. Sales of principal residence

A taxpayer generally is able to exclude up to $250,000 ($500,000 if married filing a joint return) of gain realized on the sale or exchange of a principal residence. To be eligible for the exclusion, the taxpayer must have owned the residence and used it as a principal residence for at least two of the five years prior to the sale or exchange. A taxpayer who fails to meet these requirements by reason of a change of place of employment, health, or unforeseen circumstances is able to exclude a fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of the two years that the requirements are met. For example, an unmarried taxpayer who owns and uses a principal residence for one year, has a change in place of employment and sells the residence at a realized gain of $500,000 may exclude $125,000 of gain (one-half of $250,000). Similarly, an unmarried taxpayer who owns and uses a principal residence for one year, has a change in place of employment and then sells the residence at a realized gain of $50,000 may exclude the entire $50,000 of gain since it is less than one half of $250,000.

b. Deferrals of income

Present law provides that the inclusion of certain items of income is deferred until a later year. The benefit of deferral depends in part on the tax rate the individual will face in the future compared with current rates. If an individual expects that his or her tax rate will be lower in the future (e.g., because the individual will have less income in the future) or that tax rates in the future will be lower due to changes in the law, then the individual may wish to defer a portion of his or her income. Even in the case of stable tax rates over time, the deferral of income provides the taxpayer with a time value of money benefit. Many of the provisions providing for the deferral of income are intended to encourage savings by individuals.

i. Individual retirement arrangements

In general

Present law provides tax favored treatment for individual retirement arrangements ("IRAs"). The tax treatment depends on whether an individual makes deductible IRA contributions, contributions to a Roth IRA, or nondeductible IRA contributions. The benefit of the provisions relating to deductible and Roth IRAs is similar. The tax benefit of making nondeductible contributions to an IRA is different. Deductible IRAs and Roth IRAs effectively exempt earnings on invested sums from tax, while the nondeductible IRA taxes earnings, but on a deferred basis.[13]

Deductible IRA contributions

Under present law, an individual may make deductible contributions to an IRA up to the lesser of $2,000 or the individual's compensation if the individual and the individual's spouse are not active participants in an employer-sponsored retirement plan. In the case of a married couple, deductible IRA contributions of up to $2,000 can 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. If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the $2,000 deduction limit is phased out for taxpayers with adjusted gross income ("AGI") over certain levels for the taxable year.

The AGI phase-out limits for a single individual who is an active participant in an employer-sponsored retirement plan are as follows: for 1999, $31,000 to $41,000; for 2000, 2001 and 2002, the limits increase by $1,000 each year, so that the limits by 2002 are $34,000 to $44,000; for 2003, $40,000 to $50,000; for 2004, $45,000 to $55,000; and for 2005 and thereafter, $50,000 to $60,000.

The AGI phase-out limits for a married individual filing a joint return who is an active participant in an employer-sponsored plan are as follows: for 1999, $51,000 to $61,000; for 2000, 2001 and 2002, the limits increase by $1,000 each year, so that the limits by 2002 are $54,000 to $64,000; for 2003, $60,000 to $70,000; for 2004, $65,000 to $75,000; for 2005, $70,000 to $80,000; for 2006, $75,000 to $85,000; and for 2007 and thereafter, $80,000 to $100,000.

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[13] For further discussion of this issue, see Joint Committee on Taxation, *Description and Analysis of Tax Proposals Relating to Individual Savings and IRAs* (JCS-2-97), March 3, 1997.

If the individual is not an active participant in an employer-sponsored retirement plan, but the individual's spouse is, the $2,000 deduction limit is phased out for taxpayers with AGI between $150,000 and $160,000.

Amounts held in a regular IRA are includible in income when withdrawn (except to the extent the withdrawal is a return of nondeductible contributions). Includible amounts withdrawn prior to attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death or disability, is made in the form of certain periodic payments, is used to pay medical expenses in excess of 7.5 percent of AGI, is used to purchase health insurance of an unemployed individual, is used for education expenses, or is used for first-time homebuyer expenses of up to $10,000.

Table 2 shows the distribution by income of taxpayers making contributions to deductible IRAs and those in the AGI phase-out range.

Table 2.--Distribution By Income of Taxpayers Making Contributions to Deductible IRAs and Those in the Contribution Phase-out Range [Calendar Year 1999]

Income category[1]	Taxpayers making contribution to deductible IRAs (millions)	Taxpayers in the contribution phase-out range (millions)
Less than $10,000	0.1	0.0
$10,000 to $20,000	0.2	0.0
$20,000 to $30,000	0.5	(2)
$30,000 to $40,000	0.6	0.3
$40,000 to $50,000	0.7	0.1
$50,000 to $75,000	1.6	0.3
$75,000 to $100,000	1.5	(2)
$100,000 to $200,000	1.4	0.1
$200,000 and over	0.4	(2)
Total, all taxpayers:	7.0	0.8

Detail may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.
[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

Roth IRAs

Beginning in 1998, individuals with AGI below certain levels may make nondeductible contributions to a Roth IRA. The maximum annual contribution that may be made to a Roth IRA is the lesser of $2,000 or the individual's compensation for the year. The contribution limit is reduced to the extent an individual makes contributions to any other IRA for the same taxable year. As under the rules relating to IRAs generally, a contribution of up to $2,000 for each spouse may be made to a Roth IRA provided the combined compensation of the spouses is at least equal to the contributed amount. The maximum annual contribution that can be made to a Roth IRA is phased out for single individuals with AGI between $95,000 and $110,000, and for married individuals filing joint returns with AGI between $150,000 and $160,000.

Taxpayers with modified AGI of $100,000 or less generally may convert a deductible or nondeductible IRA into an Roth IRA. The amount converted is includible in income as if a withdrawal had been made, except that the 10-percent early withdrawal tax does not apply and, if the conversion occurred in 1998, the income inclusion may be spread ratably over 4 years. An individual who converts a regular IRA into a Roth IRA may recharacterize the Roth IRA back to the prior form of IRA and, subject to limitations on frequency and timing, may reconvert the recharacterized IRA back to a Roth IRA.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that is made (1) after the 5-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) after attainment of age 59-1/2, on account of death or disability, or for first-time homebuyer expenses of up to $10,000.

To the extent attributable to earnings, a distribution from a Roth IRA that is not a qualified distribution is includible in income and subject to the 10-percent early withdrawal tax (unless an exception applies).[14] The same exceptions to the early withdrawal tax that apply to regular IRAs apply to Roth IRAs. The early withdrawal tax will apply, however, to any portion of a distribution attributable to a conversion from a deductible or nondeductible IRA if the distribution occurs within the 5-taxable year period beginning with the taxable year in which the conversion occurs (unless an exception applies).

Nondeductible IRA contributions

To the extent an individual cannot or does not make deductible contributions to an IRA or contributions to a Roth IRA, the individual may make nondeductible contributions to an IRA. Distributions from a nondeductible IRA are includible in income and subject to the 10-percent early withdrawal tax to the extent attributable to earnings.

ii. Employer-sponsored retirement plans

Qualified plans and cash or deferred arrangements

A plan of deferred compensation that meets the qualification standards of the Internal Revenue Code (a qualified plan) is accorded special treatment under present law. Employees do not include qualified plan benefits in gross income until the benefits are distributed, even though the plan is funded and the benefits are nonforfeitable. The employer is entitled to a current deduction (within limits) for contributions to a qualified plan even though the contributions are

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[14] Early distribution of converted amounts may also accelerate income inclusion of converted amounts that are taxable under the 4-year rule applicable to 1998 conversions.

not currently included in an employee's income. Contributions to a qualified plan are held in a tax-exempt trust.

The tax treatment of contributions under qualified plans is essentially the same as that of deductible IRAs. However, the limits on contributions to qualified plans are much higher than the IRA contribution limits, so that qualified plans provide for a greater accumulation of funds on a tax-favored basis. In return for greater tax benefits, qualified plans are subject to rules that do not apply to IRAs, such as nondiscrimination rules designed to help ensure that a qualified plan benefits a broad group of employees and does not discriminate in favor of highly compensated employees.

Qualified plan benefits are generally subject to tax when received under rules similar to those that apply to IRA withdrawals.

A qualified cash or deferred arrangement, commonly referred to as a 401(k) plan, is one type of qualified plan frequently used by employers. In general, a cash or deferred arrangement is an arrangement under which an employee can elect to receive an amount in cash or have it contributed to a tax-qualified pension plan. Amounts that are contributed to the plan are not included in income until withdrawn from the plan. Qualified cash or deferred arrangements are subject to the rules applicable to qualified plans generally, and are also subject to additional rules, including special nondiscrimination rules. The maximum annual amount that an employee can elect to have contributed to a cash or deferred arrangement is limited to $10,000 (for 1999). This dollar limit is indexed for inflation.

Other employer-sponsored retirement plans[15]

Present law contains provisions relating to a variety of other types of employer-sponsored retirement plans which have the same tax benefits as tax-qualified plans. These include SIMPLE retirement plans, simplified employee pensions, and tax-sheltered annuities.

iii. Education IRAs

Taxpayers may establish certain trusts or custodial accounts created exclusively for the purpose of paying qualified higher education expenses of a named beneficiary ("education IRAs"). Annual contributions to education IRAs may not exceed $500 per designated beneficiary, and may not be made after the designated beneficiary reaches age 18. The

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[15] Under present law, some individuals defer significant amounts of compensation pursuant to so-called nonqualified deferred compensation plans. These plans are not provided for under specific Code provisions and are not subject to specific rules in the Code as are tax-qualified and similar plans discussed in the text. Rather, the deferral occurs pursuant to the generally applicable income tax rules, discussed above.

contribution limit is phased out for taxpayers with modified AGI between $95,000 and $110,000 ($150,000 and $160,000 for taxpayers filing joint returns); the AGI of the contributor not the beneficiary) controls whether a contribution is permitted by the taxpayer. No contribution may be made to an education IRA during any year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary (see below).

Earnings on contributions to an education IRA generally are subject to tax when withdrawn. However, distributions from an education IRA are excludable from the gross income of the distributee (i.e., the student) to the extent that the distribution does not exceed the qualified higher education expenses incurred by the beneficiary during the year the distribution is made (provided that a HOPE credit or Lifetime Learning credit is not claimed with respect to the beneficiary for the same taxable year). The earnings portion of an education IRA distribution not used to pay qualified higher education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.

iv. Qualified State tuition programs

Present law provides tax-exempt status to "qualified State tuition programs," meaning certain programs established and maintained by a State (or agency or instrumentality thereof) under which persons may (1) purchase tuition credits or certificates on behalf of a designated beneficiary that entitle the beneficiary to a waiver or payment of qualified higher education expenses of the beneficiary, or (2) make contributions to an account that is established for the purpose of meeting qualified higher education expenses of the designated beneficiary of the account. Under present law, distributions from, and earnings under, a qualified state tuition program are included in the gross income of a contributor to, or beneficiary of, such a program, except that (1) amounts distributed for educational benefits provided to a beneficiary (e.g., when the beneficiary attends college) are included in the beneficiary's gross income (unless excludable under another Code section) to the extent such amounts or the value of the educational benefits exceed contributions made on behalf of the beneficiary, and (2) amounts distributed to a contributor or another distributee (e.g., when a parent receives a refund) are included in the contributor's/distributee's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary. Earnings on an account may be refunded to a contributor or beneficiary, but the State or instrumentality must impose a more than de minimis monetary penalty unless the refund is (1) used for qualified higher education expenses of the beneficiary, (2) made on account of the death or disability of the beneficiary, or (3) made on account of a scholarship received by the designated beneficiary to the extent the amount refunded does not exceed the amount of the scholarship used for higher education expenses.

v. Deferred annuities

Present law provides that income credited to a deferred annuity contract is not currently includible in the gross income of the owner of the contract. In addition, the income is not taxed to the insurance company issuing the contract. No deduction is provided for, and no dollar limits are imposed on, amounts used to purchase annuity contracts. In general, amounts received by the owner of an annuity contract before the annuity starting date (including loans under or secured by the contract) are includible in gross income as ordinary income to the extent that the cash value of the contract exceeds the owner's investment in the contract. In addition, a portion of each distribution received after the annuity starting date is treated as ordinary income based on the ratio of the investment in the contract to the total distributions expected to be received.

A 10-percent additional income tax is imposed on certain early withdrawals under an annuity contract. This additional tax does not apply to any distribution made after the owner of the contract attains age 59-1/2, receives annuity payments under the contract, or satisfies certain other requirements.

vi. Life insurance

No Federal income tax generally is imposed on a policyholder with respect to the earnings under a life insurance contract ("inside buildup"). Further, death benefits paid under a life insurance contract are excluded from income, so that neither the policyholder nor the policyholder's beneficiary is ever taxed on the inside buildup if the proceeds of the policy are paid to the policyholder's beneficiary by reason of the death of the insured. In addition, certain amounts received under a life insurance contract on the life of a terminally ill or chronically ill individual are treated as being received by reason of the death of the insured and therefore are excludable from income. This same favorable tax treatment applies to amounts received from the sale or assignment to a viatical settlement provider of a life insurance contract on the life of a terminally ill or chronically ill individual. The favorable tax treatment for life insurance contracts is available only if the policyholder has an insurable interest in the insured when the contract is issued and if the life insurance contract meets certain requirements designed to limit the investment character of the contract.

Except as described above, distributions from a life insurance contract (other than a modified endowment contract) that are made prior to the death of the insured generally are includible in income only to the extent that the amounts distributed exceed the taxpayer's investment in the contract; such distributions generally are treated first as a tax-free recovery of the taxpayer’s investment in the contract, and then as income. In the case of a modified endowment contract, distributions are treated as income first, loans are treated as distributions (i.e., income rather than basis recovery first), and an additional 10-percent tax is imposed on the income portion of distributions made before age 59-1/2 and in certain other circumstances. A modified endowment contract is a life insurance contract that does not meet a statutory "7-pay" test, i.e., generally is funded more rapidly than 7 annual level premiums.

No deduction is provided for, and no dollar limits are imposed on, amounts used by an individual to purchase life insurance contracts.

vii. Incentive stock options

An incentive stock option ("ISO") is an option granted to an employee of a corporation in connection with the employee's performance of services for the corporation that meets certain specified requirements. For example, the option must be granted to pursuant to a plan which includes the aggregate number of shares which may be issued under options and the employees (or class of employees) who may receive the options. The option must be granted within 10 years of the date the plan is adopted, must be exercisable no more than 10 years following the grant of the option, and meet certain other requirements.

In absence of a special rule, upon exercise of an ISO the individual generally[16] would have ordinary income equal to the excess of the fair market value of the stock on the exercise date over the option price (and the corporation would be entitled to a deduction equal to that amount). However, under a special rule, no amount is includible in the income of an individual (and the corporation is not entitled to a deduction) due to the exercise of an ISO. Rather, the individual will have income only to the extent of gain realized upon disposition of the stock acquired pursuant to the ISO. At that time, the income realized would be capital gain rather than ordinary income if the individual disposes of the stock more than 1 year after exercise of the ISO and 2 years after grant of the ISO.

viii. Sales of stock to employee stock ownership plans

An individual who sells certain stock to an employee stock ownership plan ("ESOP") defers recognition of gain (or loss) on the sale to the extent the individual uses the proceeds to purchase qualified replacement property. In general, qualified replacement property is defined as any security issued by a domestic operating company that does not have passive investment income of more than 25 percent of the gross receipts of the company. Gain may be deferred until the individual disposes of the qualified replacement property. This treatment applies only to the sale of stock issued by a domestic corporation that does not have any outstanding stock that is readily tradable. This treatment does not apply unless the employee stock ownership plan owns at least 30 percent of the stock of the corporation that issued the stock after the sale.

ix. Property received in connection with the performance of services

An individual who receives property (other than cash or a stock option) in connection with the performance of services for the party that transfers the property generally does not include the value of the property in income as long as the property is both nontransferable and is subject to a substantial risk of forfeiture. Property is subject to a substantial risk of forfeiture if the recipient's rights to full enjoyment of the property are conditioned upon future performance

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[16] If the option itself had a fair market value, then the value of the option generally would be includible in income.

of substantial services by any individual. At the first time the property becomes either transferable or nonforfeitable, the recipient generally recognizes as ordinary income the fair market value of the property at such time. When the recipient disposes of the property, any gain attributable to increase in the value of the property after the property first becomes transferable or nonforfeitable will be capital gain. The recipient may elect to recognize ordinary income equal to the fair market value of the property on the date of transfer even though the property is both nontransferable and subject to a substantial risk of forfeiture. If the recipient makes this election, any increase in the value of the property after the date of transfer will be capital gain.

x. Other nontaxable exchanges

Present law includes a number of provisions under which no gain or loss is recognized on the exchange or transfer of certain types of property. Recognition of gain (or loss) is deferred until the property acquired in the exchange is disposed of. These provisions include: exchanges of like-kind property; involuntary conversions of property; exchanges of insurance policies; and transfers of property incident to divorce.

3. Deductions from income

a. Above-the-line deductions

Once an individual determines his or her gross income by including those income items that are subject to the individual income tax and omitting those items that are deferred or excluded, the individual determines his adjusted gross income ("AGI"). An individual's AGI is determined by subtracting certain "above-the-line" deductions from gross income. These deductions include trade or business expenses, certain capital losses, contributions to a tax-qualified retirement plan by a self-employed individual, contributions to IRAs, interest on certain student loans, alimony payments, and certain moving expenses.

b. Personal exemptions (including the personal exemption phaseout ("PEP"))

In order to determine taxable income, an individual reduces AGI by any personal exemption, deductions, and either the applicable standard deduction or itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents (sec. 151). For 1999, the amount deductible for each personal exemption is $2,750. This amount is indexed annually for inflation.[17] The deduction for personal exemptions is phased out (personal exemption phaseout or "PEP") for taxpayers with incomes over certain thresholds. These thresholds of PEP are indexed annually for inflation. Under PEP, the applicable thresholds for 1999 are $126,600 for single individuals, $189,950 for married individuals filing a joint

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[17] "Indexed for inflation" generally refers to the present-law mechanism for inflation indexing. This measurement is made in reference to the Consumer Price Index ("CPI").

return, $158,300 for heads of households, and $94,975 for married individuals filing separate returns. For 1999, the point at which a taxpayer's personal exemptions are completely phased out are $249,100 for single individuals, $312,450 for married individuals filing a joint return, $280,800 for heads of households, and $156,225 for married individuals filing separate returns.

Table 3 shows the number of taxpayers claiming personal exemptions and the effect of PEP by income class.

Table 3.--Distribution By Income of Taxpayers Claiming Personal Exemptions and Those Subject to the Personal Exemption Phaseout [Calendar Year 1999]

Income category[1]	Taxpayers claiming personal exemptions (millions)	Taxpayers subject to the personal exemption phaseout (millions)
Less than $10,000	22.4	0.0
$10,000 to $20,000	26.3	0.0
$20,000 to $30,000	20.3	0.0
$30,000 to $40,000	15.9	0.0
$40,000 to $50,000	13.1	0.0
$50,000 to $75,000	19.8	0.0
$75,000 to $100,000	10.0	0.0
$100,000 to $200,000	8.5	0.5
$200,000 and over	2.5	1.3
Total, all taxpayers:	138.8	1.8

Details may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

Source: Staff of the Joint Committee on Taxation.

c. Standard deduction

A taxpayer also may reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 1999, the amount of the standard deduction is $4,300 for single individuals, $6,350 for heads of households,

$7,200 for married individuals filing jointly, and $3,600 for married individuals filing separately. Additional standard deductions are allowed with respect to any individual who is elderly (age 65 and over) or blind.[18] The amounts of the basic standard deduction and the additional standard deductions are indexed annually for inflation.

d. Itemized deductions

In lieu of taking the applicable standard deductions, an individual may elect to itemize deductions. The deductions that may be itemized include: charitable contributions; home mortgage interest; State and local income, real property, and certain personal property taxes; medical expenses (in excess of 7.5 percent of AGI); certain investment interest expense; nonbusiness casualty and theft losses; gambling losses; and certain miscellaneous expenses (in excess of 2 percent of AGI).

i. Description of commonly used itemized deductions

Charitable contributions.--Generally, a taxpayer who itemizes deductions may deduct cash contributions to charity, as well as the fair market value of contributions of property (sec. 170). The amount of the deduction allowable for the taxable year with respect to a charitable contribution may be reduced, depending on the type of property contributed, the type of charitable organization to which the property is contributed, and the income of the taxpayer.

Mortgage interest.--Qualified residence interest is deductible notwithstanding the general rule that personal interest is nondeductible (sec. 163(h)). Qualified residence interest generally is interest on (1) debt to acquire, construct, or substantially improve a principal or second residence (up to a total debt of $1 million), plus (2) debt (not in excess of $100,000) secured by a principal or second residence.

State and local taxes.--Itemizers may deduct three types of State and local taxes that are not incurred in a trade or business or in an investment activity--individual income taxes, real property taxes, and personal property taxes (sec. 164).[19]

Medical expenses.--Medical expenses in excess of 7.5 percent of AGI generally are deductible if not reimbursed by insurance or otherwise (sec. 213). Medical expenses eligible for the deduction are amounts paid by the taxpayer for (1) certain health insurance (including

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[18] For 1999, the additional amount for married individuals is $850, while the additional amount for single individuals and heads of households is $1,050.

[19] For more detailed discussion, see Joint Committee on Taxation, *Impact on State and Local Governments and Tax-Exempt Organizations of Replacing the Federal Income Tax* (JCS-4-96), April 30, 1996.

employee contributions to employer health plans); (2) the diagnosis, treatment, or prevention of disease or malfunction of the body, (3) transportation primarily for and essential to medical care, and (4) qualified long-term care services (as defined in sec. 7702B(c)).

Investment interest.--The amount of investment interest an individual may deduct in a taxable year is limited to the amount of net investment income for that year (sec.163(d)). Excess amounts of investment interest are carried forward. To the extent that an individual elects to treat long-term capital gain as investment income, for purposes of computing the investment interest limitation, that amount of net capital gain does not qualify for preferential capital gains treatment.

Nonbusiness casualty and theft losses.--Individuals who itemize deductions may deduct losses of property not connected with a trade or business or a transaction entered into for profit if the loss arises from theft or from fire, storm, shipwreck, or other casualty (sec. 165). Only the amount of the loss in excess of $100 per casualty loss can be deducted. In addition, the casualty losses of a taxpayer for a taxable year (determined after application of the $100 threshold to each loss) may be deducted only to the extent that the sum of such losses (net of casualty gains) exceeds 10 percent of the taxpayer's AGI.

Gambling losses.--Gambling losses are allowed as an itemized deduction only to the extent of gains from gambling (sec. 165).

Miscellaneous itemized deductions.--An individual may claim an itemized deduction for certain miscellaneous expenses in excess of 2 percent of AGI (sec. 67). These expenses include unreimbursed employee expenses such as certain business and professional dues, job search expenses, uniform costs and home office deductions. To be deductible, an unreimbursed employee business expense must be: (1) paid or incurred during the taxable year; (2) for carrying on the trade or business of being an employee; and (3) an ordinary and necessary business expense. Generally, the taxpayer applies the 2-percent AGI limit after any other deduction limit (such as the 50-percent limit on expenses for business-related meals and entertainment).

ii. Limitation on itemized deductions

The total amount of itemized deductions allowed is reduced but not eliminated for taxpayers with incomes over a certain threshold amount, which is indexed annually for inflation (sec. 68). This deduction limitation is referred to as the "Pease" limitation. The threshold amount for 1999 is $126,600 ($63,300 for married individuals filing separate returns). All itemized deductions are subject to the limit except: (1) medical expenses; (2) investment interest expenses; (3) nonbusiness casualty and theft losses; and (4) gambling losses. For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by 3 percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit. Therefore, all individuals subject to the limitation may deduct at least 20 percent of those deductions if they choose to itemize their deductions.

iii. Data relating to itemized deductions

Table 4 shows the distribution across income classes of taxpayers claiming itemized deductions, taxpayers subject to the "Pease" overall limitation on certain itemized deductions, taxpayers claiming the medical deduction, and taxpayers claiming miscellaneous itemized deductions.

Table 4.--Distribution by Income of Taxpayers Claiming Itemized Deductions and Taxpayers Subject to Various Limitations on Itemized Deductions [Calendar Year 1999]

Income category[1]	Taxpayers claiming itemized deductions (millions)	Taxpayers subject to Pease limitation (millions)	Taxpayers claiming medical deductions (millions)	Taxpayers claiming miscellaneous deductions (millions)
Less than $10,000	0.5	0.0	(2)	(2)
$10,000 to $20,000	1.2	0.0	0.2	0.1
$20,000 to $30,000	2.4	0.0	0.5	0.4
$30,000 to $40,000	3.7	0.0	0.8	0.8
$40,000 to $50,000	4.3	0.0	0.7	1.0
$50,000 to $75,000	10.2	0.1	1.3	2.2
$75,000 to $100,000	7.3	0.1	0.5	1.6
$100,000 to $200,000	7.2	2.6	0.2	1.5
$200,000 and over	2.3	2.3	(2)	0.4
Total, all taxpayers:	39.1	5.0	4.2	8.0

Detail may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

4. Regular income tax rates

a. Rate structure

Income tax rate structure

To determine tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. The income bracket amounts are indexed for inflation. Separate rate schedules apply based on an individual's filing status. In order to limit multiple uses of a graduated rate schedule within a family, the net unearned income of a child under age 14 is taxed as if it were the parent's income. For 1999, the individual income tax rate schedules are shown in Table 5.

Table 5.–Federal Individual Income Tax Rates for 1999

If taxable income is:	Then income tax equals:
Single individuals	
$0-25,750	15 percent of taxable income
$25,750-$62,450	$3,862.50, plus 28% of the amount over $25,750
$62,450-$130,250	$14,138.50 plus 31% of the amount over $62,450
$130,250-$283,150	$35,156.50 plus 36% of the amount over $130,250
Over $283,150	$90,200.50 plus 39.6% of the amount over $283,150
Heads of households	
$0-$34,550	15 percent of taxable income
$34,550-$89,150	$5,182.50 plus 28% of the amount over $34,550
$89,150-$144,400	$20,470.50 plus 31% of the amount over $89,150
$144,400-$283,150	$37,598 plus 36% of the amount over $144,400
Over $283,150	$87,548 plus 39.6% of the amount over $283,150
Married individuals filing joint returns	
$0-$43,050	15 percent of taxable income
$43,050-$104,050	$6,457.50 plus 28% of the amount over $43,050
$104,050-$158,550	$23,537.50 plus 31% of the amount over $104,050
$158,550-$283,150	$40,432.50 plus 36% of the amount over $158,550
Over $283,150	$85,288.50 plus 39.6% of the amount over $283,150

b. Capital gains and losses

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, any gain generally is included in income, and the net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held for more than one year.

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

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. Government 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. Gain from the disposition of depreciable personal property is not treated as capital gain to the extent of all previous depreciation allowances. Gain from the disposition of depreciable real property is generally not treated as capital gain to the extent of the depreciation allowances in excess of the allowances that would have been available under the straight-line method of depreciation.

The maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. In addition, any adjusted net capital gain which otherwise would be taxed at a 15-percent rate is taxed at a 10-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.

The "adjusted net capital gain" of an individual is the net capital gain reduced (but not below zero) by the sum of the 28-percent rate gain and the unrecaptured section 1250 gain. The net capital gain is reduced by the amount of gain which the individual treats as investment income for purposes of determining the investment interest limitation under section 163(d).

The term "28-percent rate gain" means the amount of net gain attributable to long-term capital gains and losses from the sale or exchange of collectibles (as defined in section 408(m) without regard to paragraph (3) thereof) ("collectibles gain and loss"), an amount of gain equal to the amount of gain excluded from gross income under section 1202, relating to certain small business stock ("section 1202 gain"),[20] the net short-term capital loss for the taxable year, and any long-term capital loss carryover to the taxable year.

"Unrecaptured section 1250 gain" means any long-term capital gain from the sale or exchange of section 1250 property (i.e., depreciable real estate) held more than one year to the extent of the gain that would have been treated as ordinary income if section 1250 applied to all depreciation, rather than only to a portion of the depreciation, reduced by the net loss (if any) attributable to the items taken into account in computing 28-percent rate gain. The amount of unrecaptured section 1250 gain (before the reduction for the net loss) attributable to the disposition of property to which section 1231 applies shall not exceed the net section 1231 gain for the year.

The unrecaptured section 1250 gain is taxed at a maximum rate of 25 percent, and the 28-percent rate gain is taxed at a maximum rate of 28 percent. Any amount of unrecaptured section 1250 gain or 28-percent rate gain otherwise taxed at a 15-percent rate is taxed at the 15-percent rate.

For taxable years beginning after December 31, 2000, any gain from the sale or exchange of property held more than five years which would otherwise be taxed at the 10-percent rate will instead be taxed at an 8-percent rate. Any gain from the sale or exchange of property held more than five years and the holding period for which begins after December 31, 2000, which would otherwise be taxed at a 20-percent rate will be taxed at an 18-percent rate. A taxpayer holding a capital asset or property used in the trade or business on January 1, 2001, may elect to treat the asset as having been sold on that date for an amount equal to its fair market value, and having been reacquired for an amount equal to such value.

Table 6, below, shows a breakdown of capital gains rates under present law for each individual marginal tax rate bracket and alternative minimum tax rate bracket.

[20] This results in a maximum effective regular tax rate on qualified gain from small business stock of 14 percent.

Table 6.–Tax Rates Applicable Under Present Law to Capital Gains

	Regular tax rate bracket					Minimum tax rate bracket	
Category of gain	15%	28%	31%	36%	39.6%	26%	28%
Short-term capital gain[1]	15	28	31	36	39.6	26	28
Long-term capital gain[2]	10	20	20	20	20	Same as regular tax	Same as regular tax
Section 1250 gain[3]	15	25	25	25	25	25	25
Collectible gain	15	28	28	28	28	26	28
Small business stock[4]	7.5	14	14	14	14	18.46[5]	19.88[5]
5-year gains after December 31, 2000	8	18/20[6]	18/20[6]	18/20[6]	18/20[6]	Same as regular tax	Same as regular tax

1 Gain from assets held not more than one year.
2 Gain from assets held more than one year not included in another category.
3 Capital gain attributable to depreciation on section 1250 property (i.e., depreciable real estate).
4 Effective rate after application of 50-percent exclusion for small business stock held more than 5 years.
5 Effective rate taking into account the minimum tax preference for the excluded gain. If the holding period for the stock begins after 2000, the rates are 16.64% and 17.92%, respectively.
6 The 18% rate applies to property the holding period for which begins after 2000.

5. Tax credits

a. Child tax credit

Present law provides a $500 tax credit for each qualifying child under the age of 17. A qualifying child is defined as an individual for whom the taxpayer can claim a dependency exemption and who is a son or daughter of the taxpayer (or a descendent of either), a stepson or stepdaughter of the taxpayer or an eligible foster child of the taxpayer. The child credit is nonrefundable for taxpayers with fewer than three children, but may be partially refundable for certain taxpayers with three or more children.

For taxpayers with modified AGI in excess of certain thresholds, the otherwise allowable child credit is phased out. Specifically, the otherwise allowable child credit is reduced by $50 for each $1,000 of modified AGI (or fraction thereof) in excess of the threshold ("the modified AGI phaseout"). For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively). For married taxpayers filing joint returns, the threshold is $110,000. For taxpayers filing single or head of household returns, the threshold is $75,000. For married taxpayers filing separate returns, the threshold is $55,000. These thresholds are not indexed for inflation. The length of the phase-out range is affected by the number of the taxpayer's qualifying children. In 1999, the length of the phase-out range is $10,000 of modified AGI for each qualifying child. For example, in 1999 the phase-out range for a single person with one qualifying child is between $75,000 and $85,000 of modified AGI. The phase-out range for a single person with two qualifying children is between $75,000 and $95,000 of modified AGI in 1999.

Table 7 shows the number of taxpayers claiming the child credit and the number of taxpayers in the phase-out range by income class.

Table 7.--Distribution By Income of Taxpayers Claiming Child Tax Credit and Those in Phase-out Range [Calendar Year 1999]

Income category[1]	Taxpayers claiming child tax credit (millions)	Taxpayers in phase-out range (millions)
Less than $10,000	0.1	0.0
$10,000 to $20,000	2.3	0.0
$20,000 to $30,000	4.7	0.0
$30,000 to $40,000	3.5	0.0
$40,000 to $50,000	3.2	0.0
$50,000 to $75,000	5.8	(2)
$75,000 to $100,000	3.4	0.1
$100,000 to $200,000	1.9	0.6
$200,000 and over	0.0	0.0
Total, all taxpayers:	25.0	0.7

Detail may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.
[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

b. Earned income credit

Certain eligible low-income workers are entitled to claim a refundable earned income credit on their income tax return (sec. 32). A refundable credit is a credit that not only reduces an individual's tax liability but allows refunds to the individual in excess of income tax liability. The amount of the credit an eligible individual may claim depends upon whether the individual has one, more than one, or no qualifying children, and is determined by multiplying the credit rate by the individual's[21] earned income up to an earned income amount. The maximum amount

[21] In the case of a married individual who files a joint return with his or her spouse, the income for purposes of these tests is the combined income of the couple.

of the credit is the product of the credit rate and the earned income amount. The credit is phased out above certain income levels. For individuals with earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range, the maximum credit amount is reduced by the phase-out rate multiplied by the earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range. For individuals with earned income (or modified AGI, if greater) in excess of the end of the phase-out range, no credit is allowed.

The parameters of the credit for 1999 are provided in Table 8.

Table 8.–Earned Income Credit Parameters (1999)

	Two or more qualifying children	One qualifying child	No qualifying children
Credit rate (percent)	40.00	34.00	7.65
Earned income amount	$9,540	$6,800	$4,530
Maximum credit	$3,816	$2,312	$347
Phase-out begins	$12,460	$12,460	$5,670
Phase-out rate (percent)	21.06	15.98	7.65
Phase-out ends	$30,580	$26,928	$10,200

c. Dependent care credit

A nonrefundable credit against income tax liability is available for up to 30 percent of a limited dollar amount of employment-related child and dependent care expenses (sec. 21). The credit may be claimed by an individual who maintains a household that includes one or more qualifying individuals. A qualifying individual is a child or other dependent who is under the age of 15, a physically or mentally incapacitated dependent, or a physically or mentally incapacitated spouse.

Employment-related expenses are expenses for the care of a qualifying individual, if incurred to enable the taxpayer to be gainfully employed. The amount of employment-related expenses that may be taken into account in computing the credit generally may not exceed an individual's earned income or, in the case of married taxpayers, the earned income of the spouse with the lesser earnings. Thus, if one spouse is not employed, no credit is generally allowed. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual, and $4,800 if there are two or more qualifying individuals.

The 30-percent credit rate is reduced by one percentage point for each $2,000 (or fraction thereof) of AGI above $10,000. Because married couples must file a joint return to claim the credit, a married couple's combined AGI is used for purposes of this computation. Individuals with more than $28,000 of AGI are entitled to a credit equal to 20 percent of allowable employment-related expenses.

Table 9 shows the distribution by income of taxpayers claiming the dependent care tax credit and those taxpayers in the partial phase-out range.

Table 9.--Distribution By Income of Taxpayers Claiming Dependent Care Tax Credit and Those in Partial Phase-out Range [Calendar Year 1999]

Income category[1]	Taxpayers claiming dependent care tax credit (millions)	Taxpayers in phase-out range (millions)
Less than $10,000	0.0	0.0
$10,000 to $20,000	0.4	0.4
$20,000 to $30,000	0.9	0.9
$30,000 to $40,000	0.7	0.2
$40,000 to $50,000	0.8	(2)
$50,000 to $75,000	1.3	(2)
$75,000 to $100,000	0.9	(2)
$100,000 to $200,000	0.8	0.0
$200,000 and over	0.1	0.0
Total, all taxpayers:	6.0	1.6

Detail may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

d. Education credits

i. HOPE credit

Individual taxpayers are allowed to claim a nonrefundable HOPE credit against Federal income taxes up to $1,500 per student for qualified tuition and fees paid during the year on behalf of a student (i.e., the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer) who is enrolled in a post-secondary degree or certificate program at an eligible post-secondary institution on at least a half-time basis. The HOPE credit is available only for the first two years of a student's post-secondary education. The credit rate is 100 percent of the first $1,000 of qualified tuition and fees and 50 percent on the next $1,000 of qualified tuition and fees.

The HOPE credit amount that a taxpayer may otherwise claim is phased out for taxpayers with modified adjusted gross income (AGI) between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). For taxable years beginning after 2001, the $1,500 maximum HOPE credit amount and the AGI phase-out range will be indexed for inflation. The HOPE credit is available for expenses paid after December 31, 1997, for education furnished in academic periods beginning after such date.

ii. Lifetime Learning credit

If a student is not eligible for the HOPE credit (or in lieu of claiming a HOPE credit with respect to a student), individual taxpayers are allowed to claim a nonrefundable Lifetime Learning credit against Federal income taxes equal to 20 percent of qualified tuition and fees paid during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or a dependent. In contrast to the HOPE credit, the student need not be enrolled on at least a half-time basis in order to be eligible for the Lifetime Learning credit, which is available for an unlimited number of years of post-secondary training. For expenses paid before January 1, 2003, up to $5,000 of qualified tuition and fees per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and fees per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000). The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased out over the same modified AGI phase-out range as applies for purposes of the HOPE credit. The Lifetime Learning credit is available for expenses paid after June 30, 1998, for education furnished in academic periods beginning after such date.

Table 10 shows the distribution by income class of taxpayers claiming the HOPE and Lifetime Learning tax credits and those taxpayers in the phase-out range.

Table 10.--Distribution By Income of Taxpayers Claiming HOPE and Lifetime Learning Tax Credits and Those in Phase-out Range [Calendar Year 1999]

Income category[1]	Taxpayers claiming HOPE and Lifetime Learning credits (millions)	Taxpayers in phase-out range (millions)
Less than $10,000	0.1	0.0
$10,000 to $20,000	0.7	0.0
$20,000 to $30,000	1.6	0.0
$30,000 to $40,000	1.4	0.0
$40,000 to $50,000	1.3	0.3
$50,000 to $75,000	1.8	0.2
$75,000 to $100,000	1.3	0.5
$100,000 to $200,000	0.3	0.3
$200,000 and over	0.0	0.0
Total, all taxpayers:	8.4	1.4

Detail may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable Social Security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

[2] Less than 50,000 taxpayers.

Source: Staff of the Joint Committee on Taxation.

e. Other individual tax credits

i. Credit for the elderly and disabled

Present law provides a nonrefundable credit against income tax liability for individuals who are age 65 or over, or who have retired on permanent and total disability (sec. 22). For this purpose, an individual is considered permanently and totally disabled ("disabled") if he or she is unable to engage in any substantial gainful activity by reason of any medically determinable physical or mental impairment that can be expected to result in death, or which has lasted or can be expected to last for a continuous period of not less than 12 months. The individual must furnish proof of disability to the IRS.

The credit equals 15 percent of an initial base amount, as specified in the statute, that is reduced by the amount of certain tax-free income received by the taxpayer and by one-half of the taxpayer's AGI exceeding a specified threshold.

The initial base amount is $5,000, in the case of an unmarried elderly or disabled individual or in the case of a married couple filing a joint return if only one spouse is eligible for the credit; $7,500, in the case of a married couple filing a joint return with both spouses eligible for the credit; or $3,750, in the case of a married couple filing separate returns. For a disabled individual who is under age 65, however, the initial base amount is the lesser of the applicable specified amount or the individual's disability income for the year. Consequently, the maximum credit available is $750 (15 percent x $5,000), $1,125 (15 percent x $7,500), or $562.50 (15 percent x $3,750), depending on the initial base amount applicable to the taxpayer.

The initial base amount is reduced by the amount of certain nontaxable income of the taxpayer, such as nontaxable pension and annuity income or nontaxable Social Security, railroad retirement, or veterans' nonservice-related disability benefits. In addition, the initial base amount is reduced by one-half of the taxpayer's AGI in excess of $7,500, in the case of a single individual; $10,000, in the case of married taxpayers filing a joint return; or $5,000, in the case of married taxpayers filing separate returns.

ii. Adoption tax credit

Taxpayers are entitled to a maximum nonrefundable credit against income tax liability of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer (sec. 23). In the case of a special needs adoption, the maximum credit amount is $6,000 ($5,000 in the case of a foreign special needs adoption). A special needs child is a child who the State has determined: (1) cannot or should not be returned to the home of the birth parents, and (2) has a specific factor or condition because of which the child cannot be placed with adoptive parents without adoption assistance. The adoption of a child who is not a citizen or a resident of the United States is a foreign adoption.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys' fees, and other expenses that are directly related to the legal adoption of an eligible child. All reasonable and necessary expenses required by a State as a condition of adoption are qualified adoption expenses. Otherwise qualified adoption expenses paid or incurred in one taxable year are not taken into account for purposes of the credit until the next taxable year unless the expenses are paid or incurred in the year the adoption becomes final.

An eligible child is an individual (1) who has not attained age 18 or (2) who is physically or mentally incapable of caring for himself or herself. After December 31, 2001, the credit will be available only for domestic special needs adoptions. No credit is allowed for expenses incurred (1) in violation of State or Federal law, (2) in carrying out any surrogate parenting arrangement, (3) in connection with the adoption of a child of the taxpayer's spouse, (4) that are reimbursed under an employer adoption assistance program or otherwise, or (5) for a foreign adoption that is not finalized.

The credit is phased out ratably for taxpayers with modified AGI above $75,000, and is fully phased out at $115,000 of modified AGI. For these purposes modified AGI is computed by increasing the taxpayer's AGI by the amount otherwise excluded from gross income under Code sections 911, 931, or 933.

iii. First-time homebuyer credit for the District of Columbia

First-time homebuyers of a principal residence in the District of Columbia may be eligible for a tax credit of up to $5,000 of the amount of the purchase price. The $5,000 maximum credit amount applies both to individuals and married couples. Married individuals filing separately can claim a maximum credit of $2,500 each. The first-time homebuyer credit is available only for property purchased after August 4, 1997, and before January 1, 2001.

The credit phases out for individual taxpayers with modified AGI between $70,000 and $90,000 ($110,000-$130,000 for joint filers). For this purpose, modified AGI means adjusted gross income increased by any amount excluded under section 911 (certain foreign earned income), section 931 (income from sources within Guam, American Samoa, or the Northern Mariana Islands), or section 933 (income from sources within Puerto Rico).

f. General business tax credits

i. Low-income housing tax credit

A tax credit having a 70-percent present value is allowed on qualified low-income rental housing (sec. 42). The credit is reduced to 30 percent for housing receiving most other Federal subsidies. In certain difficult-to-develop areas, the credit is increased by 30 percent (e.g., from 70 to 91 percent). The credit applies to the eligible basis of low-income housing units.

Credits are subject to annual allocations of $1.25 per resident of each State. State housing agencies allocate this amount to eligible projects. Credit amounts that are not allocated in the year in which the cap amount arises may be carried forward by the State for allocation in the following year. Any amounts remaining unallocated after that time revert to a national pool and are reallocated among States that allocated their entire credit amount in the preceding year.

ii. Rehabilitation tax credit

An income tax credit is provided for certain expenditures incurred in the rehabilitation of certified historic structures and certain nonresidential buildings placed in service before 1936 (sec. 47). The amount of the credit is determined by multiplying the applicable rehabilitation percentage by the basis of the property that is attributable to qualified rehabilitation expenditures.

The applicable rehabilitation percentage is 20 percent for certified historic structures and 10 percent for qualified rehabilitated nonresidential buildings (other than certified historic structures) that were originally placed in service before 1936.

B. Individual Alternative Minimum Tax ("AMT")

In general

Present law imposes a minimum tax on an individual to the extent the taxpayer's minimum tax liability exceeds his or her regular tax liability. This alternative minimum tax ("AMT") is imposed upon individuals at rates of (1) 26 percent on the first $175,000 of alternative minimum taxable income in excess of a phased-out exemption amount and (2) 28 percent on the amount in excess of $175,000. The exemptions amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return. These exemption amounts are phased-out by an amount equal to 25 percent of the amount that the individual's alternative minimum taxable income exceeds a threshold amount. These threshold amounts are $150,000 in the case of married individuals filing a joint return and surviving spouses; $112,500 in the case of other unmarried individuals; and $75,000 in the case of married individuals filing a separate return, estates, and trusts. The exemption amounts, the threshold phase-out amounts, and the $175,000 break-point amount are not indexed for inflation. The lower capital gains rates applicable to the regular tax also apply for purposes of the AMT.

Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

Preference items in computing AMTI

The minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. This preference does not apply to percentage depletion allowed with respect to oil and gas properties.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. This preference does not apply to independent producers to the extent the producer's AMTI is reduced by 40 percent or less by ignoring the preference.

(3) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(4) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

(5) Forty-two percent of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter, farm, or passive activities are denied.[22]

Adjustments in computing AMTI

The adjustments that individuals must make are:

(1) Depreciation on property placed in service after 1986 and before January 1, 1999, must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property. Depreciation on property placed in service after December 31, 1998, is computed by using the regular tax recovery periods and the AMT methods described in the previous sentence.

(2) Mining exploration and development costs must be capitalized and amortized over a 10-year period.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

(4) The amortization deduction allowed for pollution control facilities placed in service before January 1, 1999 (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax), must be calculated under the alternative depreciation system (generally, using longer class lives and the straight-line method). The amortization deduction allowed for pollution control facilities placed in service after December 31, 1998, is calculated using the regular tax recovery periods and the straight-line method.

(5) Miscellaneous itemized deductions are not allowed.

(6) Deductions for State, local, and foreign real property taxes; State and local personal property taxes; and State, local, and foreign income, war profits, and excess profits taxes are not allowed.

(7) Medical expenses are allowed only to the extent they exceed ten percent of the taxpayer's adjusted gross income.

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[22] Given the passage of section 469 by the Tax Reform Act of 1986 (relating to the deductibility of losses from passive activities), these provisions are largely "deadwood."

(8) Standard deductions and personal exemptions are not allowed.

(9) The amount allowable as a deduction for circulation expenditures must be capitalized and amortized over a 3-year period.

(10) The amount allowable as a deduction for research and experimental expenditures must be capitalized and amortized over a 10-year period.[23]

(11) The special regular tax rules relating to incentive stock options do not apply.

Other rules

The combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's AMT liability by more than 90 percent of the amount determined without these items.

The various nonrefundable credits allowed under the regular tax generally are allowed only to the extent that the individual's regular tax exceeds the tentative minimum tax. The earned income credit and the child credit of those taxpayers with three or more qualified children are refundable credits and may offset the taxpayer's tentative minimum tax. However, a taxpayer must reduce these refundable credits by the amount the taxpayer's tentative minimum tax exceeds his or her regular tax liability.[24]

If an individual is subject to AMT in any year, the amount of tax exceeding the taxpayer's regular tax liability is allowed as a credit (the "AMT credit") in any subsequent taxable year to the extent the taxpayer's regular tax liability exceeds his or her tentative minimum tax in such subsequent year. For individuals, the AMT credit is allowed only to the extent the taxpayer's AMT liability is a result of adjustments that are timing in nature. Most individual AMT adjustments relate to itemized deductions and personal exemptions and are not timing in nature.

Data on taxpayers affected by the AMT

Relatively few individuals have been subject to the AMT. Table 11 presents individual AMT data and projections for the 1987-2009 tax years.

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[23] No adjustment is required if the taxpayer materially participates in the activity that relates to the research and experimental expenditures.

[24] For 1998 only, the nonrefundable personal credits were not limited by the tentative minimum tax, and the refundable child credit was not reduced by the minimum tax.

Table 11.–Individual Income Tax Returns With Tax Liability Under the Individual Alternative Minimum Tax, 1987-2009, actual and projected

Year	Number of returns paying AMT (millions)	Percentage of filed returns paying AMT	Excess of AMT liability over regular tax liability ($billions)
1987	0.140	0.1	1.7
1988	0.134	0.1	1.0
1989	0.117	0.1	0.8
1990	0.132	0.1	0.8
1991	0.244	0.2	1.2
1992	0.287	0.3	1.4
1993	0.335	0.3	2.1
1994	0.369	0.3	2.2
1995	0.414	0.4	2.3
1996	0.478	0.4	2.8
1997	data not available	data not available	data not available
1998	data not available	data not available	data not available
1999	0.823	0.6	3.6
2000	0.942	0.7	3.8
2001	1.170	0.9	4.3
2002	1.402	1.1	4.9
2003	1.834	1.4	5.7
2004	2.411	1.8	6.9
2005	3.075	2.3	8.3
2006	4.085	3.0	10.2
2007	5.412	3.9	12.9
2008	6.918	4.9	15.8
2009	9.043	6.3	19.8

Note: These statistics represent taxpayers who actually pay AMT and do not include taxpayers whose regular tax liabilities are affected by the AMT through tax credit limitations. See Tables 15, 16, and 17 for such data.

Source: Internal Revenue Service, *Statistics of Income*, 1987-1996; projections for years 1999-2009 from Joint Committee on Taxation estimates.

Tables 12 and 13 below report how individual AMT taxpayers are estimated to be distributed across various income classes in 2000 and 2008.

Table 12.--Distribution of Individual AMT Taxpayers with AMT Liability under Present Law, 2000

Income category[1]	Number of returns (thousands)	AMT taxpayers as a percentage of all taxpayers
Less than $10,000	(2)	(3)
$10,000 to less than $20,000	1	(3)
$20,000 to less than $30,000	2	(3)
$30,000 to less than $40,000	15	0.1
$40,000 to less than $50,000	15	0.1
$50,000 to less than $75,000	79	0.4
$75,000 to less than $100,000	135	1.3
$100,000 to less than $200,000	300	3.5
$200,000 and over	389	15.1
Total (all taxpayers):	**937**	**0.7**

(1) The income concept used to place tax returns into income categories is AGI plus: (a) tax-exempt interest; (b) employer contributions to health plans and life insurance; (c) employer share of FICA tax; (d) workers compensation; (e) nontaxable Social Security benefits; (f) insurance value of Medicare benefits; (g) AMT preference items; and (h) excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels. Excludes individuals who are dependents of other taxpayers and taxpayers with negative income, resulting in differences with Table 1.

(2) Less than 500.

(3) Less than .05 percent.

Details may not add to totals due to rounding.

Source: Staff of the Joint Committee on Taxation.

Table 13.--Distribution of Individual AMT Taxpayers with AMT Liability under Present Law, 2008

Income category(1)	Number of returns (millions)	AMT taxpayers as a percentage of all taxpayers
Less than $10,000	0.001	(2)
$10,000 to less than $20,000	0.001	(2)
$20,000 to less than $30,000	0.014	0.1
$30,000 to less than $40,000	0.114	0.6
$40,000 to less than $50,000	0.170	1.2
$50,000 to less than $75,000	1.060	4.4
$75,000 to less than $100,000	1.661	12.3
$100,000 to less than $200,000	2.568	22.9
$200,000 and over	1.319	40.6
Total (all taxpayers):	**6.906**	**4.6**

(1) Same income concept as used in Table 2, measured at 1999 levels.
(2) Less than .05 percent.
Details may not add due to rounding.

Source: Staff of the Joint Committee on Taxation.

The increase in the number of taxpayers subject to the AMT largely can be attributed to the fact that the personal exemptions, standard deduction, and tax bracket break points of the regular tax are indexed for inflation, while the AMT exemption amounts and tax bracket break point are not indexed for inflation. Proposals that would increase or index these amounts would decrease the number of taxpayers subject to the AMT and reduce the tax burden of those individuals otherwise subject to the AMT.[25] Even with indexing, one would expect some growth in AMT taxpayers as real (i.e., inflation-adjusted) incomes rise over time.

[25] Both the House- and Senate-passed versions of H.R. 2014, the "Taxpayer Relief Act of 1997," would have increased or indexed the exemption amounts of the individual AMT. However, the final conference agreement on H.R. 2014 as passed by the Congress and signed by the President, did not contain any provision to change the AMT exemption amounts (P.L. 105-34, August 5, 1997).

The lack of indexing in the AMT also explains the increase of AMT taxpayers in the middle-income categories. Under present law, the relatively large AMT exemption amounts[26] shelter most of a low- or middle-income taxpayer's AMTI from tax. However, over time, with inflation, a taxpayer's income is expected to grow in nominal dollars. Most of this inflated income of a middle-income individual will remain subject to tax at a 15-percent rate for regular tax purposes because the personal exemptions, standard deduction, and tax bracket break points of the regular tax are indexed for inflation. However, for AMT purposes, relatively less of the taxpayer's inflated income will be sheltered by the unindexed AMT exemption amount and the amount not sheltered will become subject to the higher AMT rate of 26 percent. Because the AMT exemption amounts are phased out over relatively high levels of AMTI, indexing these amounts would provide benefits to taxpayers in all income classes.[27]

Table 14 demonstrates the results if the AMT exemption amounts were indexed for inflation, starting in 1999. With indexing, the number of taxpayers subject to AMT and the amount of AMT collected is expected to remain relatively constant.

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[26] The exemptions amounts are $45,000 in the case of married individuals filing a joint return and surviving spouses; $33,750 in the case of other unmarried individuals; and $22,500 in the case of married individuals filing a separate return.

[27] The phase-out ranges are $150,000 to $330,000 of AMTI for married individuals filing a joint return and surviving spouses; $112,500 to $262,500 of AMTI for other unmarried individuals; and $75,000 to $165,000 of AMTI for married individuals filing singly.

Table 14.--Projected Individual Income Tax Returns With Tax Liability Under the Individual AMT If Exemptions Were Indexed, 1999-2008

Year	Number of returns paying AMT (millions)	Percentage of filed returns paying AMT	Excess of AMT liability over regular tax liability ($billions)
1999	0.747	0.6	3.4
2000	0.723	0.6	3.4
2001	0.758	0.6	3.6
2002	0.769	0.6	3.7
2003	0.775	0.6	3.8
2004	0.818	0.6	4.1
2005	0.851	0.6	4.4
2006	0.887	0.7	4.7
2007	0.941	0.7	5.2
2008	0.958	0.7	5.5
2009	1.016	0.7	5.9

Source: Staff of the Joint Committee on Taxation.

As described above, the AMT acts as a floor with respect to the utilization of nonrefundable credits in that a taxpayer is allowed to reduce his or her regular tax liability with otherwise allowable credits only to the extent the taxpayer's regular tax exceeds his or her tentative minimum tax. Tables 15, 16, and 17, below, demonstrate the estimated effects of the AMT on all nonrefundable tax credits, the child credit, and the education credits, respectively. Projections on the child and education credits are provided because these credits were only recently enacted by the Congress in 1997, they significantly increased the number of taxpayers eligible for nonrefundable credits, and they were targeted toward taxpayers with middle incomes.

Consistent with the projections in Table 11, relatively few taxpayers currently have tax credit utilization that is limited because of the AMT. However, over time, the number of taxpayers subject to this limitation is expected to increase. This pattern is consistent with the expected increase in the number of AMT taxpayers.

Table 15.--Projected Individual Income Tax Returns With Nonrefundable Tax Credits, 2000 and 2008 (in millions)

	Taxable year 2000	Taxable year 2008
Returns with nonrefundable credits	46.9	49.0
Returns receiving full credits	18.2	15.1
Returns receiving zero or less than full credits	28.7	33.9
Returns affected by the AMT	1.1	6.0

Source: Staff of the Joint Committee on Taxation.

Table 16.--Projected Individual Income Tax Returns With Child Credits, 2000 and 2008[1] (in millions)

	Taxable year 2000	Taxable year 2008
Returns with dependents under age 17	39.4	40.6
Returns receiving full child credit	20.5	15.8
Returns receiving zero or less than full child credit	18.9	24.8
Returns affected by the AMT	0.6	5.0

[1] Includes refundable portion of the credit.

Source: Staff of the Joint Committee on Taxation.

Table 17.--Projected Individual Income Tax Returns With HOPE and Lifetime Learning Credits, 2000 and 2008 (in millions)

	Taxable year 2000	Taxable year 2008
Returns with tuition expense	15.2	16.1
Returns receiving full education credit	5.7	5.1
Returns receiving zero or less than full education credit	9.5	11.3
Returns affected by the AMT	0.5	1.8

Source: Staff of the Joint Committee on Taxation.

C. Employment Taxes

1. Social Security tax

As part of the Federal Insurance Contributions Act ("FICA"), a tax is imposed on employees and employers up to a maximum amount of employee wages. The tax is composed of two parts: old-age, survivor, and disability insurance ("OASDI") (i.e., Social Security) and Medicare hospital insurance. The OASDI tax rate is 6.2 percent on both the employer and employee (for a total rate of 12.4 percent). The OASDI tax rate applies to wages up to the OASDI wage base, which is $72,600 for 1999. "Wages" generally includes all remuneration for employment, but there are specific exemptions. The wage base cap is indexed for changes in averages. Revenues from the OASDI tax are credited to the Social Security Trust Fund.

2. Medicare tax

The second part of the FICA tax imposed on employees and employers is for Medicare hospital insurance ("HI"). The HI tax rate is 1.45 percent on both the employee and employer (for a total rate of 2.9 percent). There is no limit on the amount of wages subject to the HI portion of the FICA tax. Revenues from the HI tax are credited to the Hospital Insurance Trust Fund.

3. Self-employment tax

Under the Self-Employment Contributions Act ("SECA"), a tax is imposed on an individual's net earnings from self-employment. The SECA tax rate is the same as the total FICA tax rates for employers and employees and is capped at the same levels. Thus, the OASDI tax rate is 12.4 percent and the HI tax rate is 2.9 percent. The OASDI tax rate applies to the first $72,600 (for 1999) of net earnings and the HI tax rate applies to all net earnings. A self-employed individual is entitled to deduct one-half of his or her self-employment taxes.

4. Unemployment compensation tax

The Federal Unemployment Tax Act ("FUTA") imposes a 6.2-percent gross tax rate on the first $7,000 paid annually by covered employers to each employee. Employers in States with programs approved by the Federal Government and with no delinquent Federal loans may credit 5.4 percentage points against the 6.2-percent tax rate, making the minimum, net Federal unemployment tax rate 0.8 percent. Because all States have approved programs, 0.8 percent is the Federal tax rate that generally applies. This Federal revenue finances administration of the system, half of the Federal-State extended benefits program, and a Federal account for State loans. The States are supposed to use the revenue turned back to them by the 5.4-percent credit to finance their regular State programs and half of the Federal-State extended benefits program.

In 1976, Congress passed a temporary surtax of 0.2 percent of taxable wages to be added to the permanent FUTA tax rate. Thus, the current 0.8-percent FUTA tax rate has two components: a permanent tax rate of 0.6 percent, and a temporary surtax rate of 0.2 percent. The temporary surtax subsequently has been extended through 2007.

5. Treatment of household employees

The employment tax treatment of household employees has received considerable attention, and the rules relating to such workers substantially were revised in 1994 in order to simplify administration and increase compliance. Under present law, if a household employee receives cash wages of $1,100 or more (for 1998) during a calendar year, all the individual's wages are subject to FICA taxes. An employer may pay the household employee's liability for FICA taxes without deduction from the employee's wages. If an employer pays the household employee's FICA liability, those payments are not wages for FICA purposes but are wages for income tax withholding purposes.

FUTA taxes are imposed on the employer if a household employee receives cash wages of $1,000 or more in a calendar quarter in the current or preceding calendar year. If the employer pays the household employee's FICA liability without deducting those taxes from the employee's wages, the amounts paid by the employer are not wages for FUTA purposes.

FICA and FUTA taxes for household employees are payable annually with the employer's individual tax return. For years beginning after 1998, in certain circumstances an individual employing household employees may be subject to estimated taxes as a result of employment taxes due with respect to such employees.

D. Reporting, Withholding, and Estimated Tax Requirements

Income tax withholding and reporting

The Code requires that employers making payments of wages to employees withhold Federal income taxes from those wage payments in accordance with tables or computational procedures prescribed by the IRS (sec. 3402). Each employee must file with his or her employer a Withholding Allowance Certificate (Form W-4) on which the employee claims a specific number of withholding allowances based on family size, employment status, itemized deductions, and other matters. The employer then utilizes tables issued by the IRS to compute the correct amount of Federal income tax withholding. This computation is based on the number of withholding allowances claimed, the taxpayer's wages, and the frequency of payroll payments. The amount of wages paid and the amount of income taxes withheld must be reported to the IRS and to the employee on Form W-2 (sec. 6051).

No income tax withholding is required on payments made to independent contractors.[28] Independent contractors are required to make quarterly estimated tax payments.

Reporting requirements with respect to independent contractors

The Code contains a number of information reporting requirements. One requires that a person engaged in a trade or business who makes payments during the calendar year of $600 or more to a person for rents, salaries, wages, premiums, annuities, compensations, remunerations, emoluments, or other fixed or determinable gains, profits, and income, must file an information return with the IRS reporting the amount of such payments, as well as the name, address and taxpayer identification number of the person to whom such payments were made.[29] A similar statement must also be furnished to the person to whom such payments were made.[30]

The Code contains a separate provision (sec. 6041A) specifically dealing with payments of remuneration for services. Under this provision, a service recipient engaged in a trade or business who makes payments of remuneration in the course of that trade or business to any person for services performed must file with the Internal Revenue Service an information return (Form 1099) reporting such payments (and the name, address, and taxpayer identification number of the payee) if the remuneration paid to the person during the calendar year is $600 or more. Also, the service recipient must furnish to the person receiving such payments a statement

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[28] Payments to independent contractors may be subject to backup withholding under certain circumstances (sec. 3406).

[29] Section 6041(a). A number of exceptions to this requirement are provided in Treasury regulations. In addition, to the extent the general information reporting requirements of this provision overlap specific information reporting requirements elsewhere in the Code, taxpayers are generally required to report only once, under the more specific information reporting provision.

[30] Section 6041(d).

setting forth the name, address, and taxpayer identification number of the service recipient, and the aggregate amount of payments made to the payee during the year.

Estimated tax requirements for individuals

An individual taxpayer generally is subject to an addition to tax for any underpayment of estimated tax (sec. 6654). An individual generally does not have an underpayment of estimated tax if he or she makes timely estimated tax payments at least equal to: (1) 100 percent of the tax shown on the return of the individual for the preceding year (the "100 percent of last year's liability safe harbor") or (2) 90 percent of the tax shown on the return for the current year. The 100 percent of last year's liability safe harbor is modified to be an increased percentage of last year's liability safe harbor for any individual with an AGI of more than $150,000 as shown on the return for the preceding taxable year. These percentages are as follows:

For payments with respect to tax year	Percentage
1999	105
2000	106
2001	106
2002	112
2003 and after	110

Income tax withholding from wages is considered to be a payment of estimated taxes. In general, payment of estimated taxes must be made quarterly.

III. SOURCES OF COMPLEXITY FOR INDIVIDUALS

A. General Sources of Complexity

Need for simplification

Many commentators have written about the complexity of the present-law Federal tax system for individuals. In addition, groups such as the American Institute of Certified Public Accountants ("AICPA") have testified before the Congress about the need to reduce the complexity of present law for individuals and have made various simplification recommendations. A number of reasons for the need for simplification have been cited.

Most commentators agree that (1) a tax system should be easy both for individuals to understand and for the government to administer, and (2) the computation of tax liabilities for most taxpayers should not require tedious or time consuming computations or recordkeeping. A complicated tax system may result in inefficiencies because of high compliance costs, as well as a perception of unfairness because of the likelihood that similarly situated taxpayers will have different tax liabilities. Under a complicated tax system, taxpayers may invest large amounts of time and money both to ensure compliance with the existing system and to take advantage of opportunities to minimize their tax liability. Thus, a portion of the resources devoted to compliance with the tax law could be redirected to more productive activities if the tax law were less complicated.

A complicated tax system may result in similarly situated taxpayers reporting unequal tax liabilities because of differing abilities to understand the rules or pay for professional tax assistance. Indeed, professional tax preparers may not give similarly situated taxpayers consistent advice when the tax system is complicated. Thus, complexity in the tax system can introduce a source of inequity into the system, affecting both actual tax liabilities reported on returns and taxpayers' perceptions of equity of the system.

On the other hand, simplicity in a tax system may involve sacrifices of equity and efficiency. Rules that are complicated may result in more appropriate calculations of tax liability. Complicated tax rules often apply with respect to business and other transactions that themselves are inherently complex.

General sources of complexity

Certain general sources of complexity in the present-law rules relating to individuals can be identified. These sources of complexity include (1) elections provided to taxpayers, (2) definitional issues that taxpayers must consider, (3) recordkeeping and reporting requirements, (4) limitations on the availability of tax benefits, and (5) frequent changes in the tax laws. These sources of complexity are discussed in greater detail with respect to certain specified present-law provisions below.

Elections provided to taxpayers.–The Congress (or the Internal Revenue Service through revenue rulings and regulations) often provides for elective treatment with respect to certain transactions. These elections may be provided to taxpayers as a compromise among alternative views of the appropriate tax policy result for a particular transaction.

Elections create complexity for taxpayers because affected taxpayers must invest time and resources in determining whether or not to utilize an election provided. Thus, taxpayers may be required to compute their tax liability in two or more ways in order to determine whether it is worthwhile to take advantage of an election.

Definitions.–Complexity may be created for taxpayers by the definitions that determine whether a taxpayer qualifies for a particular tax provision. This source of complexity is compounded if different definitions are used for the same term that is used in different tax provisions. For example, there are a number of different definitions of the term "child" that apply for various purposes under present law. Complexity is created for any taxpayer who must use more than one of these definitions to determine whether an individual is the taxpayer's child. Similarly, different definitions of qualified educational expenses apply for purposes of the various educational tax incentives available under present law.

Recordkeeping and reporting.–An important aspect of the equity of a tax system involves the degree of compliance of taxpayers with the applicable laws. To facilitate compliance and to improve enforcement of the law, numerous reporting and recordkeeping requirements have been imposed on taxpayers. However, increased reporting and recordkeeping increases the burden on taxpayers. The extent of the burden and the added complexity concomitant with such burden depends on whether the information required to be reported would otherwise be collected by the taxpayer. For example, under present law, taxpayers are required to substantiate certain charitable contributions. This substantiation requirement increases recordkeeping and reporting otherwise done by both charitable organizations and individuals solely for the purpose of ensuring compliance with the tax law. Similarly, reporting requirements have been imposed on educational institutions and individuals to substantiate education expenses for purposes of certain of the education tax incentives.

Limitations on availability of tax incentives.–Some areas of complexity result because certain tax incentives have been designed to target the incentive to a particular class of taxpayer. These limitations on the availability of tax incentives may create the greatest complexity for affected individual taxpayers. For example, the numerous different phase-out ranges that apply to certain individual tax incentives increase the complexity of the Form 1040 individual income tax return. Although the number of individual taxpayers who are directly affected by the phaseouts may be relatively small relative to the universe of individual taxpayers, the added complexity of the Form 1040 will affect more than those taxpayers directly affected.

Frequent changes in the tax laws.–Frequent changes in the tax laws can contribute to complexity both for taxpayers and the government. Frequent changes in the law can increase inadvertent errors by taxpayers, as taxpayers may not be aware of the change or may inadvertently apply prior law, and can contribute to taxpayer frustration. Changes in the tax laws necessitates the expenditure of resources to educate IRS employees regarding the changes. Frequent changes in the tax laws can also delay needed regulatory or other needed administrative guidance.

B. Alternative Minimum Tax

The AMT requires a calculation of a second income tax base and computation of a tax on that base, so the present tax system, with an AMT, is not as simple to administer or comply with as the same system would be without an AMT. Relatively few taxpayers currently are subject to the AMT.[31] However, the data on taxpayers subject to the AMT understates the extent to which the AMT imposes a compliance burden on taxpayers. Many taxpayers must calculate whether, in fact, they are liable for the AMT or whether the utilization of certain credits is limited by the AMT. The IRS has provided a 12-line worksheet to see if the taxpayer needs to fill in the AMT Form 6251.[32] In addition, the IRS instructions instruct the taxpayer to fill in Form 6251 if the taxpayer has any of 13 listed preferences. The Form 6251 itself contains 50 lines to compute the minimum tax. In addition, taxpayers claiming credits must fill out worksheets to see if their credits are limited by the AMT.[33]

The projections in Table 11, in Part II.B., above, show that many more individuals will be subject to or otherwise affected by the AMT in the future. Thus, more individuals will face the added complexity of the AMT in the future. This increase in number of taxpayers affected by the AMT occurs because the exemption amount and the tax bracket break point for the AMT are not indexed for inflation.

There are no studies that specifically measure compliance costs arising from the individual AMT. Indirect evidence of the complexity imposed by the individual AMT may be the increased utilization of the services of paid tax preparers by individual taxpayers subject to the individual AMT. If taxpayers subject to the AMT are more likely to have complicated financial affairs, they might use paid tax preparers even in the absence of the AMT. However, Tables 12 and 13 indicate that middle-income taxpayers, whose financial affairs are less likely to be complicated, are more likely to become subject to the AMT in the future and thus may be faced with more complicated tax compliance burdens.

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[31] See Table 11, in Part II.B., above.

[32] A copy of this worksheet is reproduced in Appendix A, below.

[33] For 1998 only, personal credits were not limited by the AMT. A copy of Form 6251 and instructions is reproduced in Appendix A, below.

C. Treatment of Capital Gains and Losses

Unlike prior law, the capital gains reduction enacted by the Tax Relief Act of 1997 ("1997 Act") (as modified by the Internal Revenue Service Restructuring Act of 1998) is a multiple rate system: 28 percent for the sum of gain from collectibles, and includible small business gain[34]; 25 percent for unrecaptured real estate depreciation; and 20 percent (10 percent for gain otherwise taxed at 15 percent) for the remainder of the net capital gain.[35] In addition, in 2001, gain from assets held for more than 5 years will be eligible for an 8-percent rate rather than a 10-percent rate and in 2006 assets held more than 5 years and acquired after 2000 will be eligible for an 18-percent rate rather than a 20-percent rate.

Prior to 1987, individuals were allowed a 60-percent deduction for the net capital gain, a system that resulted in a different maximum effective rate for each tax rate bracket. Under the pre-1986 Act rules, no special tax computation was necessary, because a deduction was allowed in computing taxable income and then the tax was computed using the regular tax rate schedule or table. In addition, because the deduction was a single fixed percentage, it was unnecessary to apply differing percentages to different components of the net capital gain. Under this system, individuals in any tax bracket reporting capital gain only from mutual fund distributions could report 40 percent of the gain on Form 1040 and not file a Schedule D (the form to report capital gains). When the alternative rate system was in effect prior to 1978, the maximum rate system applied only to individuals in the higher rate brackets, thus allowing most individuals to report their capital gain without having to compute their tax on schedule D.

Under the rules in effect from 1991 through 1996, only individuals in the 31-percent or higher tax brackets were required to make the tax computation on the 13-line worksheet to Schedule D, because individuals with taxable incomes below the 31-percent bracket received no benefit from the 28-percent maximum rate applicable to capital gains.[36] Under the 1991-1996 rules, capital gain distributions from mutual funds for individuals in the 15- or 28-percent tax bracket could be reported directly on Form 1040 without filing a Schedule D. In 1994, 5.8 million taxpayers reported capital gain distributions in this way.

Under the rules enacted in the 1997 Act, every individual with a net capital gain (including those whose only capital gain is from mutual fund distributions) needs to complete the 36-line tax computation on Schedule D to receive the benefit of the lower capital gain rate.[37] For 1998, it is estimated that 22 million taxpayers will make these computations. The multiple rate system adopted by the 1997 Act requires Form 1099s and Schedule Ks received by holders of

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[34] For gain of $10 million or less from a single qualifying small business stock, only 50 percent of the qualifying gain is includible. This creates an effective tax rate equal to 14 percent.

[35] See Table 6, in Part II.A.4, above, which shows the various capital gains rates that apply to taxpayers in particular marginal and AMT tax rate brackets under present law.

[36] See Appendix B for a copy of the 1996 Schedule D and capital gain worksheet.

[37] See Appendix B for a copy of the 1998 Schedule D.

interests in pass-through entities, such as mutual funds, REITS, partnerships, trusts, estates, and Sub S corporations to report multiple categories of gain so that the investor may properly compute the capital gains tax. Additional calculations will have to be added to Schedule D and additional reporting will be required in both 2001 and 2006 when the additional capital gain rates become effective.

Because, under the 1997 Act, amounts taxed at the various rates are based, not on gross gains from within a category, but rather on net amounts of gain, rules for netting gains and losses are needed. The net gain must be arrived at by offsetting gains within a category by losses from within the same category as well as net long-term losses from other categories, net short-term capital losses, long-term capital loss carryovers, and ordinary losses. Also, lower capital gain rates must be computed for income otherwise taxed at the 15-percent rate. The 1997 Act sets forth rules for making these computations. Many of the additional lines added to the Schedule D for 1997 are needed to complete these computations.

Further, section 1231 provides, in general, that if there is a net long-term gain from certain assets used in a trade or business, then all the gains and losses comprising that net gain are capital gains and losses. However, if there is a net section 1231 loss, then all the gains and losses are ordinary gains and losses. When there was only one category of long-term gain and loss, any loss would offset the tax on any gain, dollar-for-dollar, whether or not the gains and losses are all characterized as capital or ordinary. Under the 1997 Act multiple rate system, because section 1231 gains and losses, if treated as long-term capital gains and losses, may fall into differing rate categories, a "notch" may be created where the net amount turns from positive to negative. The 1997 Act dealt with this problem by, in part, limiting 25-percent gain from section 1231 assets to the net section 1231 gain. This also adds additional computational complexity.

Under the 1997 Act any individual having a net capital gain and needing to compute the tentative minimum tax amount is required to fill out a 22-line tax computation on Form 6251 (Alternative Minimum Tax).

D. Income Phaseouts, Phaseins, and Floors

Present law

The Code includes 22 provisions that can increase a taxpayer's effective marginal tax rate through income phaseouts, phaseins, and floors that limit the ability of certain taxpayers to claim certain deductions, credits or other tax benefits.[38] Table 18, below, provides a summary of these provisions. The Joint Committee staff estimates that over 30 million taxpayers are subject to these provisions. The provisions affecting the most taxpayers are the phaseout of the EIC, the 2-percent floor on miscellaneous itemized deductions, the phasein of the EIC, the phaseout of the exclusion of Social Security benefits, and the overall limitation on itemized deductions.

It is possible for taxpayers to be subject to more than one of the phaseouts or phaseins simultaneously. Certain of the phaseouts are mutually exclusive--for example, a taxpayer could not simultaneously be subject to the personal exemption phaseout and the phaseout for the deductibility of interest on qualified student loans, as the income ranges of the separate phaseouts do not overlap. However, other phaseouts can overlap. Table 18 can be used as a general guide to the income levels where multiple phaseouts can overlap. Some care must be used in interpreting the table, however. For example, the table shows that taxpayers in the $20,000 to $30,000 AGI range could be subject to a combination of the EIC and dependent care credit phaseouts and the phasein of Social Security benefits. However, a taxpayer is unlikely to be subject to the Social Security inclusion and receive either the EIC or the dependent care credit, given the distinctly different demographics of the taxpayers that benefit from Social Security as compared to the other provisions.

Analysis

Many of the provisions identified in Table 18 require additional computations by taxpayers, marginally increasing both the time required to prepare the taxpayer's return and the probability of making an error. In addition to whatever additional complexity they create, such provisions may make the Code less clear and lead to taxpayer confusion regarding the individual income tax. As noted above, these provisions have the effect of increases in marginal tax rates, but are not stated as statutory rates. Likewise, taxpayers generally understand that certain deductible expenditures are "favored" and reduce their tax liability or that certain credits may be claimed for specified expenditures. Because taxpayers can not always predict what their income will be for any given year or may be unaware of all of the requirements of the Code, these provisions may make it harder for taxpayers to plan to take advantage of certain tax-favored activities.

Complexity and lack of clarity may promote taxpayer disillusionment and a sense of unfairness regarding the Code, and may reduce compliance. It probably is impossible to discern

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[38] For a detailed discussion of the effect of such provisions on marginal tax rates, see Joint Committee on Taxation, *Present Law and Analysis Relating to Individual Effective Marginal Tax Rates* (JCS-3-98), February 3, 1998.

the extent, if any, to which compliance rates have been affected by the existence of the provisions described in this section.

On the other hand, by limiting the number of taxpayers eligible to qualify for certain tax benefits, some of the provisions reduce computations, possibility of error, and recordkeeping. For example, the 7.5-percent-of-AGI floor on deductible medical expenditures eliminates the need for recordkeeping and computation for the approximately 30 million taxpayers who claim itemized deductions other than for medical expenses. It also may induce some taxpayers to claim the standard deduction, which provides significant simplification.

Some commentators have suggested that the complexity relating to these provisions should be reduced. Some propose the repeal of some or all of the phaseouts and phaseins. Others suggest the creation of a limited number of dollar ranges (e.g., low-income, middle-income and upper-income) to increase uniformity within the Code for some or all these provisions. Still others suggest conforming the definitions of modified AGI used in some of these provisions. Making any such changes would not necessarily result in simplification for all taxpayers subject to these provisions. For example, if a taxpayer is subject to only one income phaseout under present law, changing the phase-out range to the range used for other provisions would not simplify preparation of that individual's return. Indeed, such a change might add complexity for that taxpayer, because he or she would have to learn to apply a new provision.

In addition, any changes to these provisions to reduce complexity would need to be weighed against the policy provisions and Congressional intent underlying present law. Many of the provisions serve to target tax benefits to certain groups of taxpayers (e.g., the EIC is a tax benefit for lower-income individuals) or to deny certain tax benefits to higher-income taxpayers (e.g., the IRA deduction is limited for certain higher-income taxpayers). Changing the present-law phase-out ranges could alter the distribution of tax benefits among taxpayers.

Table 18.–Summary of Present-Law Individual Tax Provisions With Income Phaseins or Phaseouts, or AGI Floors (1999)

Provision	Code Section	Applicable Range of AGI
Phaseout of exclusion of social security benefits	Section 86	**First tier:** *Single:* \$25,000-various[1] *Joint:* \$32,000-various[1] **Second tier:** *Single:* \$34,000-various[1] *Joint:* \$44,000-various[1]
Overall limitation on itemized deductions ("Pease")	Section 68	\$126,600-various[1]
7.5-percent of AGI floor on medical deduction	Section 213	Any taxpayer itemizing medical deductions
2-percent of AGI floor on miscellaneous	Section 67	Any taxpayer itemizing miscellaneous deductions
10-percent floor on casualty loss	Section 165(h)(2)	Any taxpayer itemizing casualty loss deductions
Phaseout of personal exemption	Section 151	*Single:* \$126,600-\$249,100 *H/H:* \$158,300-\$280,800 *Joint:* \$189,950-\$312,450
Phasein of earned income credit	Section 32	*No children*: \$0-\$4,530[2] *One child*: \$0-\$6,800[2] *Two children*: \$0-\$9,540[2]
Phaseout of earned income credit	Section 32	*No children:* \$5,670-\$10,200[2,3] *One child:* \$12,460-\$26,928[2,3] *Two children:* \$12,460-\$30,580[2,3]
Phaseout of child credits	Section 24	*Single:* \$75,000-various[3] *Joint:* \$110,000[3]
Partial phaseout of dependent care credit	Section 21	\$10,000-\$28,001
Phaseout of eligibility for deductible IRA	Section 219	*Single:* \$31,000-\$41,000 *Joint:* \$51,000-\$61,000

Table 18.--Summary of Present-Law Individual Tax Provisions With Phaseins or Phaseouts (1999), continued

Provision	Code Section	Applicable Range of AGI
Phaseout of eligibility for Roth IRA	Section 408A	*Single:* \$95,000-\$110,000 *Joint:* \$150,000-\$160,000
Phaseout of eligibility for education IRA	Section 530	*Single:* \$95,000-\$110,000 *Joint:* \$150,000-\$160,000
Phaseout of HOPE credit	Section 25A	*Single:* \$40,000-\$50,000[3] *Joint:* \$80,000-\$100,000[3]
Phaseout of Lifetime Learning credit	Section 25A	*Single:* \$40,000-\$50,000[3] *Joint:* \$80,000-\$100,000[3]
Phaseout of deductibility of interest on qualified student loans	Section 221	*Single:* \$40,000-\$55,000[3] *Joint:* \$60,000-\$75,000[3]
Phaseout of exclusion of interest from education savings bonds	Section 135	*Single:* \$53,100-\$68,100[3] *H/H:* \$53,100-\$68,100[3] *Joint:* \$79,650-\$109,650[3]
Phaseout of credit for elderly and disabled	Section 22	*Single:* \$7,500-maximum of \$17,500 *Joint:* \$10,000-maximum of \$25,000
Phaseout of adoption credit and exclusion	Section 23	\$75,000-\$115,000[3]
Phaseout of first-time homebuyer credit for D.C.	Section 1400C	*Single:* \$70,000-\$90,000[3] *Joint:* \$110,000-\$130,000[3]
Phaseout of rental real estate losses under passive loss rules	Section 469(i)	\$100,000-\$150,000
Phaseout of rehab tax credit under passive loss rules	Section 469(i)	\$200,000-\$250,000
Income phase-in of recapture of subsidy of qualified mortgage bonds	Section 143	Defined relative to area median income

[1] Applicable range defined by reference to provisional income and modified AGI is used in lieu of AGI.
[2] Assumes all income is earned income.
[3] Income range measured by reference to modified AGI.

Source: Staff of the Joint Committee on Taxation.

E. Individual Retirement Arrangements ("IRAs")

The present-law provisions relating to IRAs can add to complexity for individuals. There are several reasons for this complexity, including (1) the existence of multiple options with differing requirements and tax benefits, (2) recordkeeping requirements, and (3) the application of different rules to similar types of tax-favored vehicles.

Existence of multiple options.–Although the availability of deductible IRAs, nondeductible IRAs, and Roth IRAs increases retirement savings opportunity and flexibility, the existence of multiple options also produces complexity. Different rules concerning eligibility, limitations and taxation apply to each type of IRA. The availability and/or desirability of each type of IRA varies from taxpayer to taxpayer based upon the taxpayer's age, income, filing status and participation in an employer-sponsored retirement plan. The use of one type of IRA may limit or prevent the use of another type. Because of the variation and interaction of the multiple IRA options, a taxpayer must become familiar with all of the IRA rules in order to choose the best IRA for his or her circumstances.

Table 19, below, shows a summary comparison of the present-law rules relating to IRAs, including deductible IRAs, Roth IRAs, and nondeductible IRAs.

Recordkeeping requirements.–IRA owners need to keep records in order to be able to determine the taxable portion of a withdrawal. The extent of recordkeeping requirements depends in part on the type of IRA contributions the individual has made. For example, if the individual has only a Roth IRA, then the individual will have to keep records in order to demonstrate whether a withdrawal is tax free. This involves keeping track of when an individual first established an Roth IRA. If a withdrawal does not qualify for tax-free treatment, then the individual will need to be able to determine what portion of the withdrawal, if any, is taxable. This will require keeping track of the amount of contributions and any previous distributions. If an individual has made only nondeductible contributions to an IRA, the individual will need to keep track of such contributions (and any distributions) in order to determine what portion of any distribution is taxable. The recordkeeping requirements may be more difficult if an individual has more than one IRA, or more than one type of IRA. In general, all an individual's Roth IRAs are treated as a single Roth IRA for purposes of determining whether any portion of a distribution is taxable. Thus, an individual with more than one Roth IRA will need to keep comprehensive records of all Roth IRA transactions. Regular IRAs (including IRAs to which nondeductible and deductible IRA contributions have been made) are similarly treated as a single IRA for taxation purposes. Records for such IRAs would need to be kept separately from records for any Roth IRAs. Recordkeeping will be easiest if an individual has made only deductible IRA contributions, because all withdrawals will be includible in income.

In some cases, the financial institution holding the IRA account may be able to assist the taxpayer with recordkeeping. However, this will generally be possible only if the individual's IRAs have always been maintained at the same institution. If an IRA owner transfers balances or rolls over balances between financial institutions, the new financial institution may not be able to determine the information needed to compute the amount of a distribution that is includible in income. For example, the new financial institution may not be able to determine what portion of a roll over is attributable to nondeductible contributions.

IRA owners that make taxable distributions before age 59-1/2 that are exempt from the early withdrawal tax will need to keep records to substantiate the exemption. For example, a taxpayer that makes a withdrawal from an IRA for first-time home expenses will need to establish that his or her expenses at least equaled the amount of the withdrawal.

Similar types of arrangements.–Many taxpayers view IRAs and employer-sponsored 401(k) plans in a similar light because both provide favorable tax treatment for individual taxpayer contributions to retirement savings. Furthermore, some general rules that apply to 401(k) plans also apply to one or more types of IRAs. These rules include the commencement of minimum distributions at required beginning dates and restrictions on distributions prior to the occurrence of certain events. The specific application of these rules, however, is different for 401(k) plans and IRAs and for different types of IRAs. For example, while the typical 401(k) plan participant may postpone the commencement of minimum distributions until retirement, an individual who owns a deductible IRA or a nondeductible IRA must begin receiving minimum distributions at age 70-1/2.[39] A Roth IRA owner is not required to receive any lifetime distributions. A 401(k) plan participant who receives a distribution prior to age 59-1/2 in order to pay expenses related to education, or the purchase of a home must pay a 10-percent early withdrawal tax, but an IRA owner who receives a similar distribution may be exempt from the early withdrawal tax. These differences may produce uncertainty and confusion, especially for taxpayers who have both IRAs and 401(k) plan accounts.

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[39] In addition to applying differently to various types of retirement savings arrangements, the minimum distribution rules are themselves complex. These rules govern not only the timing of lifetime distributions (except in the case of Roth IRAs), but also post-death distributions. Failure to comply with the minimum distribution rules can result in the imposition of an excise tax of 50 percent of the amount that should have been distributed but was not.

Table 19.–Summary Comparison of Present-Law Rules Relating to Individual Retirement Arrangements

Provision	Deductible IRA	Roth IRA	Nondeductible IRA
1. Eligibility to contribute	Single taxpayers under age 70½ who either are not an active participant in an employer-sponsored retirement plan or have AGI less than $41,000 (for 1999). Dollar limit increases annually until it reaches $60,000 in 2005. Married taxpayer under age 70½ filing a joint return if (a) neither taxpayer nor spouse is an active participant, or (b) taxpayer is active participant and has AGI less than $61,000 (for 1999), or (c) spouse is an active participant but taxpayer is not and has AGI less than $160,000. Dollar limit in (b) increases annually until it reaches $100,000 in 2007.	Single taxpayers with AGI of less than $110,000. Married taxpayers filing a joint return with AGI of less than $160,000.	All taxpayers with compensation under age 70 ½.
2. Maximum allowable annual contribution	The lesser of the taxpayer's compensation or $2,000. If the taxpayer files a joint return, compensation includes the compensation of the taxpayer's spouse. Limit applies to the total contributions to all of a taxpayer's IRAs. Contribution limit is reduced by taxpayer's contributions to any other IRAs.	Same as for deductible IRAs. Contribution limit is reduced by taxpayer's contributions to any other IRAs.	Same as for deductible IRAs. Contribution limit is reduced by taxpayer's contributions to any other IRAs.

Table 19.–Comparison of Present-Law Rules Relating to Individual Retirement Arrangements, continued

Provision	Deductible IRA	Roth IRA	Nondeductible IRA
3. Phaseout of maximum allowable annual contribution	For single taxpayer who is an active participant in an employer-sponsored retirement plan, in 1999, pro rata phaseout if AGI within range of $31,000 to $41,000. Phase-out range increases annually until it reaches $50,000 to $60,000 in 2005. For married taxpayer filing joint return who is an active participant in an employer-sponsored retirement plan, in 1999, pro rata phaseout if AGI within range of $51,000 to $61,000. Phase-out range increases annually until it reaches $80,000 to $100,000 in 2007. For married taxpayer filing joint return who is not an active participant but whose spouse is, pro rata phaseout if AGI within range of $150,000 to $160,000.	For single taxpayer, pro rata phaseout if AGI within range of $95,000 to $110,000. For married taxpayer filing joint return, pro rata phaseout if AGI within range of $150,000 to $160,000.	No phaseout.

Table 19.–Comparison of Present-Law Rules Relating to Individual Retirement Arrangements, continued

Provision	Deductible IRA	Roth IRA	Nondeductible IRA
4. Tax treatment of contributions	Taxpayer may deduct the contribution (up to the maximum allowable annual contribution) from gross income in the year for which the contribution is made. Contribution in excess of maximum allowable annual contribution is subject to 6% excise tax.	Taxpayer may not deduct contribution from gross income. Contribution in excess of maximum allowable annual contribution is subject to 6% excise tax.	Taxpayer may not deduct contribution from gross income. Contribution in excess of maximum allowable annual contribution is subject to 6% excise tax.
5. Tax treatment of distributions	Distributions are includible in gross income. Distributions prior to age 59-½ are subject to 10% early withdrawal tax unless an exception applies.	Distributions are not includible in gross income if distribution (a) occurs after the 5-taxable year period beginning with the taxable year of taxpayer's 1st Roth IRA contribution, and (b) occurs after age 59½, or is due to death or disability, or is used for first-time homebuyer expenses up to $10,000. To the extent attributable to earnings, a distribution that does not meet these requirements is includible in income and subject to 10% early withdrawal tax if prior to age 59½ unless an exception applies.	To the extent attributable to earnings, distributions are includible in income and is subject to 10% early withdrawl tax if it occurs prior to age 59½ unless an exception applies.

F. Provisions Relating to Education

In general

In recent years, several education financing and savings incentives have been added to the Code. As a result, there now are numerous ways that taxpayers may be able to reduce the cost of post-secondary education. Table 20 provides a summary of some of the provisions in the Code relating to education savings incentives and education financing. In addition to the provisions noted in the table, there are special rules governing the tax treatment of employer-provided education assistance, qualified scholarships and fellowships, the forgiveness of certain student loans, and withdrawals from IRAs for educational expenses.

The education incentives in the Code are structured in several different ways. Some provisions are structured as savings incentives (e.g., education IRAs and qualified state tuition programs), some are designed to reduce the cost of post-secondary education at the time educational expenses are incurred (e.g., the HOPE and Lifetime Learning credits), some provide exclusions from income for amounts used to pay for educational expenses (e.g., interest on education savings bonds), and some reduce the cost of borrowing money to pay for educational expenses (e.g., the student loan interest deduction). While the existence of a variety of tax incentives for education with differing provisions may mean that more taxpayers are able to take advantage of one or more education incentives, understanding the tax benefits provided by the different provisions, the various eligibility requirements, the interaction between different provisions, as well as the recordkeeping and reporting requirements, may be time consuming and confusing for taxpayers who are interested in reducing their current educational expenses or saving for future expenses.

Interaction among provisions

Several of the education-related provisions (including education IRAs, qualified State tuition programs, and the HOPE and Lifetime Learning credits) have restrictions on their use based upon the taxpayer's use of other education provisions. These interactions may not be obvious in all cases -- e.g., a beneficiary of an education IRA will incur an excise tax if a contribution is made on his or her behalf to a qualified state tuition program in the same year -- and, consequently, may be confusing to some taxpayers. While it is possible for taxpayers to take advantage of many or even all of the education incentives at some point, they must be careful about which incentives are selected in any particular year so as to avoid losing eligibility for a particular provision.

Differing definitions and qualifications

Several education-related provisions use different definitions for similar or identical terms. For example, several education incentives use the terms "qualified higher education expenses," "eligible educational institution," and "eligible student," but define them differently. The differences in definitions can be significant. For example, for some education provisions the term "qualified higher education expenses" includes room and board, while for others it does not. Similarly, for purposes of some provisions, an "eligible student" is defined as a student enrolled on at least a half-time basis, while for purposes of other provisions, an "eligible student" is defined to include students enrolled on a less than half-time basis. Instances where similar or identical terms are defined differently may result in confusion for those taxpayers attempting to determine whether certain persons and/or expenses meet the eligibility requirements for particular education incentives.

Income phaseouts

Several of the education-related provisions use income phaseouts to limit the availability of the provision to a particular class of taxpayers. As discussed elsewhere in this pamphlet, the use of income phaseouts results in additional computations for those taxpayers who wish to use one or more education-related provisions that have phase-out ranges. Complexity also may be created by the existence of different phase-out ranges for education incentives that can be used simultaneously. For example, a single taxpayer with modified AGI of $45,000 will be subject to different phase-out ranges for purposes of claiming the HOPE credit and the student loan interest deduction.

Furthermore, in some cases, phase-out ranges can increase complexity for several taxpayers involved a single transaction. For example, a contributor to an education IRA is unlikely to know what his or her modified AGI for that taxable year will be at the time a contribution is made and thus will not know his or her contribution limit. If, after using a worksheet to compute his or her modified AGI (which may not be the same as the AGI reported on his or her tax return) and contribution limit, the contributor determines that he or she exceeded the contribution limit in a particular year, the beneficiary is then responsible for either withdrawing the excess contributions (and the earnings thereon) before the due date of his or her return or reporting the amount of the excess contributions and paying a penalty excise tax. Thus, the phase-out ranges applicable to contributors to education IRAs can affect both the contributor to an education IRA account and the designated beneficiary of the account.

Table 20.–Comparison of Certain Education Tax Incentives Available to Individuals Under Present Law

Provisions	Tax Benefit	Contribution/ Deduction Limits	Eligible Contributors (for savings incentives)/ Eligible Claimants (for deductions, credits, and exclusions)	Eligible Beneficiaries	Qualified Education Expenses	Coordination with Other Education Provisions
1. Education IRA (sec. 530)	Earnings are not subject to tax until distributed. Distributions are not subject to tax if the amount distributed does not exceed the qualified higher education expenses of the beneficiary during the year. Earnings portion of distributions in excess of qualified expenses is subject to an additional 10-percent tax.	Annual contributions may not exceed $500 per designated beneficiary. No contributions permitted after beneficiary attains age 18.	Contribution limit phased out for contributors with modified AGI of $95,000 to $110,000 ($150,000 to $160,000 for joint returns).	Eligible distributee (i.e., student) can be enrolled on full-time, half-time, or less than half-time basis.	Includes tuition, fees, books, supplies, and equipment required for attendance at an eligible educational institution (defined in sec. 481 of the Higher Education Act of 1965). Also includes certain room and board expenses if student enrolled on at least a half-time basis. Does not include expenses covered by certain scholarships or other tax-free educational benefits. Includes amounts contributed to a QSTP for the benefit of the beneficiary of the education IRA.	No exclusion from income for a particular student if either the HOPE credit or LLC is claimed for the same year with respect to the same student. Beneficiary will incur a penalty excise tax if a contribution is made by any person to an education IRA if, in the same year, a contribution is made to a QSTP on behalf of the same beneficiary.
2. Qualified State tuition program ("QSTP") (sec. 529)	Earnings are not subject to tax until distributed. Earnings not used for qualified higher education expenses are subject to an additional penalty.	QSTP must have adequate safeguards to prevent contributions in excess of amount needed for the beneficiary's higher education expenses.	No restrictions.	No restrictions.	Same as education IRA, although there is no restriction regarding expenses covered by tax-free educational assistance.	See education IRA discussion above. HOPE credit or LLC may be claimed in same year and with respect to same expenses for which a distribution from a QSTP is made.

Table 20.–Comparison of Certain Education Tax Incentives Available to Individuals Under Present Law, continued

Provisions	Tax Benefit	Contribution/ Deduction Limits	Eligible Contributors (for savings incentives)/ Eligible Claimants (for deductions, credits, and exclusions)	Eligible Beneficiaries	Qualified Education Expenses	Coordination with Other Education Provisions
3. HOPE credit (sec. 25A)	Credit against tax for qualified tuition and related expenses for first two years of post-secondary education.	Maximum credit is $1,500, computed on a per-student basis. Credit rate is 100% on first $1,000 of qualified expenses and 50% on next $1,000 of expenses	Credit amount is phased out for taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns). Credit may be claimed by student or by another taxpayer if the taxpayer claims the student as a dependent.	Eligible student must be enrolled on at least a half-time basis and must not have been convicted of Federal or State felony involving possession or distribution of a controlled substance.	Same as education IRA, except does not include charges or fees associated with room and board, athletics (unless part of student's degree program, and nonacademic fees (including insurance, transportation, and similar personal, living or family expenses).	HOPE credit not available with respect to a particular student if, the student elects an exclusion from income for a distribution from an education IRA in the same year. Also see QSTP discussion above.
4. Lifetime Learning credit ("LLC") (sec. 25A)	Credit against tax for qualified tuition and related expenses for undergraduate or graduate (and professional) courses. Unlike HOPE credit, LLC is available for an unlimited number of years.	For expenses paid between July 1, 1998 and December 31, 2002, maximum credit is $1,000. For expenses paid after December 31, 2002, maximum credit is $2,000. Credit rate is 20% of up to $5,000 ($10,000 beginning in 2003) of qualified expenses. Unlike HOPE credit, LLC is computed on family-wide basis, rather than per-student basis.	AGI phase-out ranges are same as HOPE credit. As with HOPE credit, LLC may be claimed by student or by another taxpayer if the taxpayer claims the student as a dependent.	Eligible students include: (1) those enrolled on at least a half-time basis as part of a degree or certificate program, and (2) those enrolled in any course of instruction at an eligible educational institution to acquire or improve the job skills on a full-time, half-time, or less than half-time basis.	Same as HOPE credit.	Same as HOPE credit.

Table 20.–Comparison of Certain Education Tax Incentives Available to Individuals Under Present Law, continued

Provisions	Tax Benefit	Contribution/ Deduction Limits	Eligible Contributors (for savings incentives)/ Eligible Claimants (for deductions, credits, and exclusions)	Eligible Beneficiaries	Qualified Education Expenses	Coordination with Other Education Provisions
5. Student loan interest deduction (sec. 221)	Taxpayer may claim an above-the-line deduction for interest paid on qualified education loans, subject to an annual deduction limit.	Deduction allowed with respect to interest paid on qualified education loans during the first 60 months in which interest payments are required. Maximum deduction is $1,500 in 1999, $2,000 in 2000, and $2,500 in 2001 and thereafter.	Deduction is phased out for taxpayers with modified AGI of $40,000 to $55,000 ($60,000 to $75,000 for joint returns).	No restrictions.	Includes tuition, fees, room and board, and related expenses, reduced by (1) any interest on education savings bonds excluded from income, (2) any distribution from an education IRA excluded from income, and (3) any educational benefits (e.g., scholarships, employer-provided educational assistance) excluded from income.	No restrictions.
6. Education savings bonds (sec. 135)	Interest on certain savings bonds is not subject to tax if the proceeds of the bond upon redemption do not exceed qualified higher education expenses paid by the taxpayer during taxable year.	No limit on amount that may be excluded, but see income phase-out limitation.	For 1999, exclusion is phased out for taxpayers with modified AGI of $53,100 to $68,100 ($79,650 to $109,650 for joint returns). To prevent avoidance of the income phase-out limitation, bonds must be issued to taxpayer who is at least 24 years old.	No restrictions.	Same as for HOPE credit and LLC, but without the restriction on nonacademic fees.	For purposes of computing excludable amount, taxpayer cannot include expenses taken into account in determining the HOPE credit or LLC claimed by the taxpayer, or the excludable amount of an education IRA distribution.

G. Definition of Dependent

Present law

Personal exemption for dependent children

In general, a taxpayer is entitled to claim an exemption for any dependent child of the taxpayer. In order to claim a child as a dependent, the taxpayer must provide more than one half of the child's total support during the calendar year, as well as meet certain other requirements. For purposes of the support test, governmental benefit payments (e.g., Temporary Assistance to Needy Families ("TANF") payments, food stamps, and housing) are not treated as support provided by the taxpayer but rather are treated as support provided by the government. Expenses that are not directly related to any one member of a household, such as the cost of food for the household, must be divided among the members of the household.

To determine whether a taxpayer has provided more than half of a child's support, the amount the taxpayer contributed to the child's support is compared with the entire amount of support the child received from all sources. This amount includes the child's own funds used for support. See the illustration of the support test below.

A taxpayer may be able to claim a child as a dependent even though the taxpayer provided support for less than half the year. Support is determined based upon the amount spent, not the length of time over which it is spent. As long as the taxpayer provides more than half of the total amount of a person's support for a year, the taxpayer satisfies the support test.

The Code provides special support rules in the case of a child of parents: (1) who are divorced or legally separated under a decree of divorce or separate maintenance, (2) who are separated under a written separation agreement, or (3) who live apart at all times during the last 6 months of the calendar year. If the child is in the custody of one or both of these parents for more than one half of the calendar year, then the parent having custody for the greater portion of the calendar year is deemed to satisfy the support test. That parent can release claim to the exemption for any year by filing a proper written declaration (Form 8322 or similar statement) with the Secretary of the Treasury. Figure 2 shows the support test in the case of divorced or separated parents.

A child over the age of 19 (24 if the child is a full-time student) cannot be claimed as a dependent if the child has gross income equal to or in excess of the personal exemption amount ($2,750 for 1999). There is no gross income limit for children younger than these age thresholds. In the case of a dependent who is permanently and totally disabled, income from a sheltered workshop is not taken into account for this purpose. For purposes of the gross income test, the taxpayer's child includes a son, stepson, daughter, stepdaughter, a legally adopted child, or a child who was placed with the taxpayer by an authorized placement agency for legal adoption. A foster child who was a member of the taxpayer's household for the entire tax year is also considered the taxpayer's child.

Personal exemption for dependents other than children

A taxpayer may claim an exemption for specified relatives other than if the taxpayer provides more than half the support of the relative for the year, the relative has income less than the exemption amount, and certain other requirements are satisfied. A taxpayer may also claim an exemption for an individual other than a specified relative if the taxpayer provides more than one half of the individual's support for the year and the individual lives with the taxpayer for the entire year, has gross income less than the exemption amount, and satisfies certain other requirements. Support is generally determined using the same rules as described for children above.

Other rules

To qualify as a dependent under any category, a person must be a U.S. citizen, resident or national, or a resident of Canada or Mexico for some part of the calendar year in which the taxpayer's tax year begins. Also, a person is disqualified as a taxpayer's dependent if he or she files a joint income tax return.

In some cases no one taxpayer provides more than half of the support of a person. Instead, two or more taxpayers, each of whom would be able to take the exemption but for the support test, together provide more than half of the person's support. If this occurs, taxpayers can agree to designate that one of the taxpayers who individually provides more than 10 percent of the person's support can claim an exemption for that person. Each of the others must sign a written statement agreeing not to claim the exemption for that year. The statements must be filed with the income tax return of the person who claims the exemption.

Interaction with filing status and certain tax credits

A taxpayer may be entitled to file an income tax return as a surviving spouse or as a head of household if the taxpayer is entitled to a dependency exemption for certain dependents and the taxpayer pays more than one half of the cost of maintaining a home which is the principal place of abode for such dependents. A taxpayer may claim head of household filing status if the taxpayer pays more than one half the cost of maintaining a home which is the principal place of abode for a non-dependent, unmarried son, stepson, daughter, stepdaughter or a descendent of a son or daughter of the taxpayer.

Taxpayers with income below certain income thresholds may claim a $500 child tax credit for qualifying children claimed as a dependent who are under the age of 17 and meet certain other requirements. Similarly, a dependent care tax credit may be claimed by taxpayers who maintain a household for a dependent who is under the age of 13 or other individual who meets certain other requirements and for whom the taxpayer has paid employment related expenses to care for the child or other individual.

Illustration of dependency rules

Figure 3, below, shows the tests that apply in determining whether a taxpayer may claim an individual as a dependent for a taxable year.

Figure 2--Support Test for Children of Divorced or Separated Parents to Claim the Dependency Exemption

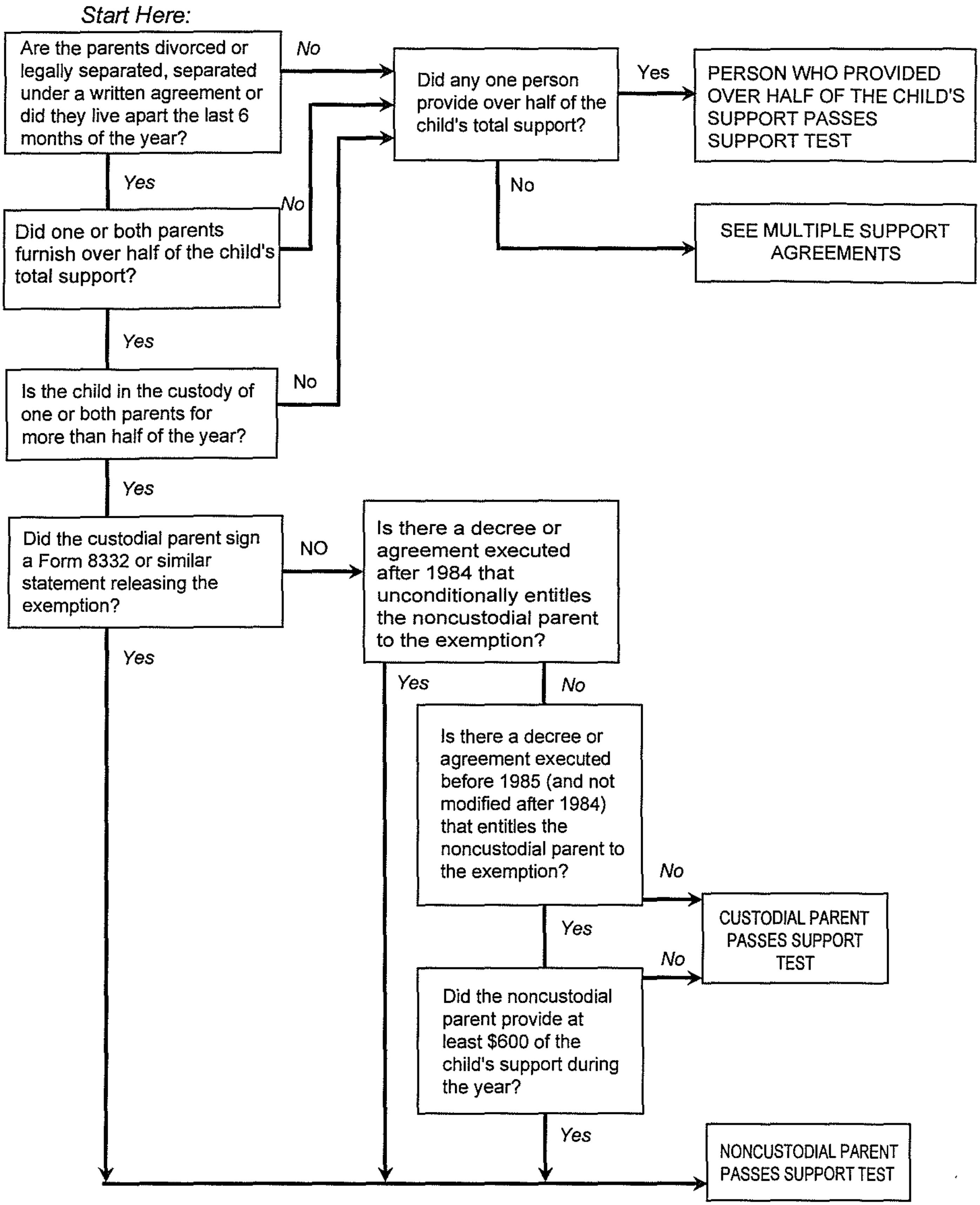
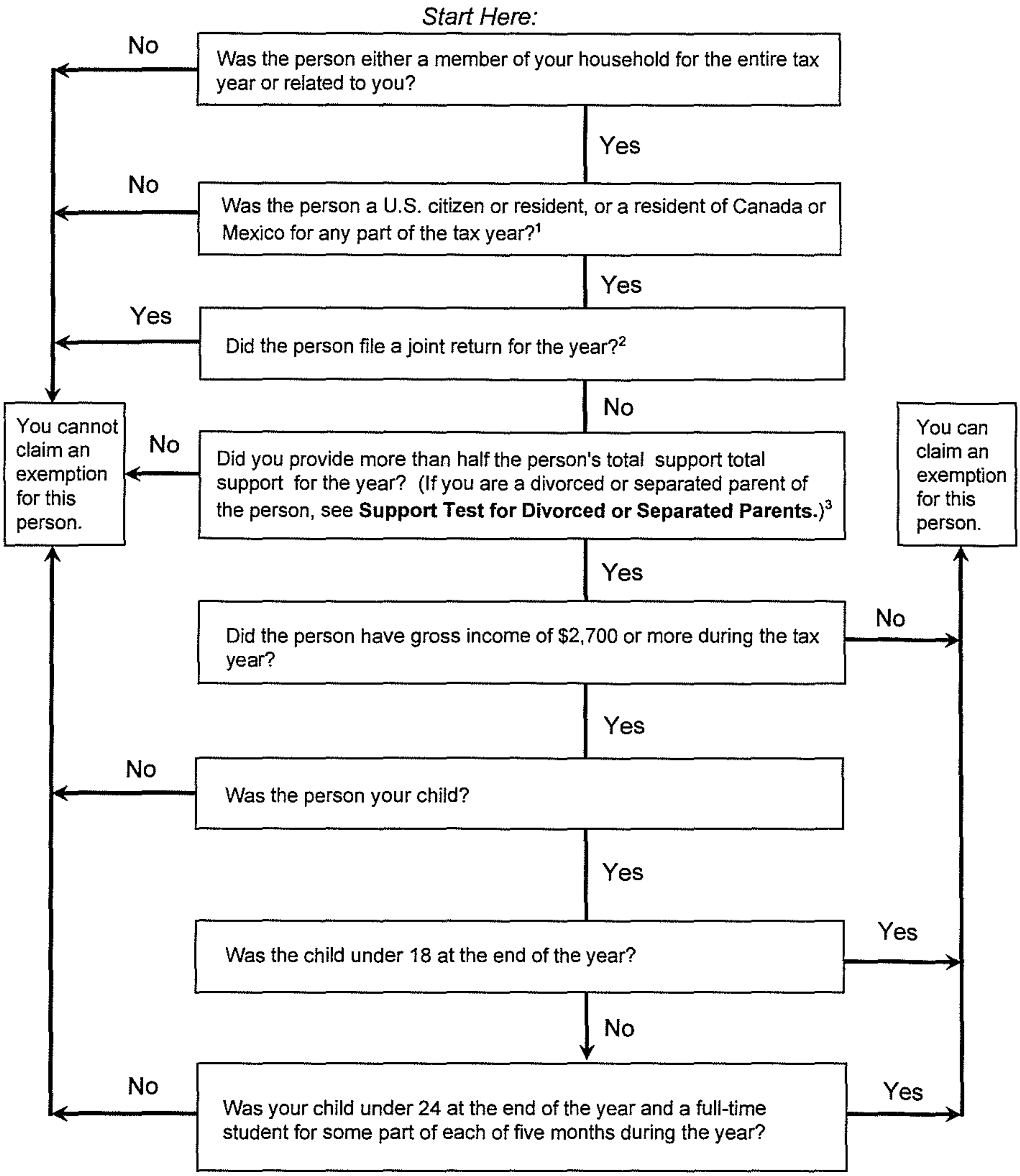


Figure 3.--Can You Claim a Dependency Exemption for a Dependent?



[1] If the person was your legally adopted child and lived in your home as a member of your household for the entire tax year, answer "yes" to this question.

[2] If neither the person nor the person's spouse is required to file a return, but they file a joint return only to claim a refund of tax withheld, answer "no" to this question.

[3] Answer "yes" to this question if your meet the multiple support requirements under *Multiple Support Agreement.*

Illustration of the support test

Certain information is needed to determine if the taxpayer provided more than one half of a person's support during the calender year. The following is illustrative of the types of information and computations which are necessary:

1. Did the proposed dependent receive any types of income such as wages, social security benefits, or other government assistance such as welfare?
   A. If yes, list total amount received.
   B. What portion of total income received was used to support the proposed dependent (excluding other uses such as savings)?
2. Total cost to maintain household
   A. List actual rent paid, or if owned list fair rental value of home.
   B. Food
   C. Utilities
   D. Insurance and other identifiable expenses
3. Total number of persons living in home
4. Living expenses of proposed dependent
   A. Household expenses (generally line 2 total costs divided by line 3.) However, if home was owned by proposed dependent, exclude fair rental value from line 2A and instead include total fair rental value here)
   B. Clothing
   C. Other expenses such as medical or education
5. Combine income proposed dependent used for support (line 1B) with other support received which was not included in line 1A (i.e., support from other relatives). This is the total support for the proposed dependent which was not provided by the taxpayer.
6. Total living expenses computed on line 4 is reduced by line 5 to arrive at the total amount of support provided by the taxpayer wishing to claim the dependency exemption.
7. If the amount of support provided by the taxpayer (line 6) exceeds 50 percent of the total living expenses of the proposed dependent (line 4), then you meet the support test for the dependency exemption.

While this computation is fairly easy for many households with a child living at home with his or her parents, the computation of support can become much more complicated in situations where multiple generations of a family are living in the same household or when a grandparent is paying for tuition and room and board expenses for a grandchild who is away at school for most of the year.

Analysis

Some argue that the definition of dependent is a significant source of complexity in the Code, in part because of its widespread applicability. In particular, some argue that the support test requires time-consuming recordkeeping and computations. Another source of complexity, some argue, is the fact that the requirements for dependency exemption are different than for other tax benefits (e.g., the earned income credit). These commentators would conform the definitions to reduce complexity.

On the other hand, some argue that, while the dependency rules are on their face complex, in practice they are not, because many taxpayers do not actually apply the support test before claiming the exemption. Some argue that, in that case, it would be appropriate to eliminate the technical complexities in the law to help prevent taxpayer mistakes and to conform the law to taxpayer practices.

H. Earned Income Credit

Present law

The earned income credit ("EIC") is available to low-income working taxpayers. Three separate schedules apply.

Taxpayers with one qualifying child may claim a credit in 1999 of 34 percent of their earnings up to $6,800, resulting in a maximum credit of $2,312. The maximum credit is available for those with earnings between $6,800 and $12,460. At $12,460 of earnings (or modified AGI, if greater) the credit begins to phase down at a rate of 15.98 percent of the amount of earnings (or modified AGI, if greater) above that amount. The credit is phased down to $0 at $26,928 of earnings (or modified AGI, if greater).

Taxpayers with more than one qualifying child may claim a credit in 1999 of 40 percent of earnings up to $9,540, resulting in a maximum credit of $3,816. The maximum credit is available for those with earnings between $9,540 and $12,460. At $12,460 of earnings (or modified AGI, if greater) the credit begins to phase down at a rate of 21.06 percent of earnings (or modified AGI, if greater) above that amount. The credit is phased down to $0 at $30,580 of earnings (or modified AGI, if greater).

Taxpayers with no qualifying children may claim a credit if they are over age 24 and below age 65. The credit is 7.65 percent of earnings up to $4,530, resulting in a maximum credit of $347. The maximum credit is available for those with incomes between $4,530 and $5,670. At $5,670 of earnings (or modified AGI, if greater), the credit begins to phase down at a rate of 7.65 percent of earnings (or modified AGI, if greater) above that amount, resulting in a $0 credit at $10,200.

All income thresholds are indexed for inflation annually.

In order to be a qualifying child, an individual must satisfy a relationship test, a residency test, and an age test. The relationship test requires that the individual be a child, a stepchild, a descendant of a child, or a foster or adopted child of the taxpayer. The residency test requires that the individual have the same place of abode as the taxpayer for more than half the taxable year. The household must be located in the United States. The age test requires that the individual be under 19 (24 for a full-time student) or be permanently and totally disabled.

An individual is not eligible for the earned income credit if the aggregate amount of "disqualified income" of the taxpayer for the taxable year exceeds $2,350. This threshold is indexed. Disqualified income is the sum of: (1) interest (taxable and tax-exempt); (2) dividends; (3) net rent and royalty income (if greater than zero); (4) capital gain net income; and (5) net passive income (if greater than zero) that is not self-employment income.

For taxpayers with earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range, the maximum EIC amount is reduced by the phase-out rate multiplied by the amount of earned income (or modified AGI, if greater) in excess of the beginning of the phase-out range. For taxpayers with earned income (or modified AGI, if greater) in excess of the end of the phase-out range, no credit is allowed.

The definition of modified AGI used for phasing out the EIC disregards certain losses. The losses disregarded are: (1) net capital losses (if greater than zero); (2) net losses from trusts and estates; (3) net losses from nonbusiness rents and royalties; and (4) 75 percent of the net losses from businesses, computed separately with respect to sole proprietorships (other than in farming), sole proprietorships in farming, and other businesses. The definition of modified AGI also includes: (1) tax-exempt interest; and (2) non-taxable distributions from pensions, annuities, and individual retirement accounts (but only if not rolled over into similar vehicles during the applicable rollover period).

Table 21 shows the number of taxpayers claiming the EIC and the number of taxpayers in the phase-in and phase-out ranges, respectively.

Table 21.--Distribution By Income of Taxpayers Claiming the Earned Income Credit and Those in the Phase-in and Phase-out Range [Calendar Year 1999]

Income category[1]	Taxpayers claiming earned income credit (millions)	Taxpayers in earned income credit phase-in range (millions)	Taxpayers in earned income credit phase-out range (millions)
Less than $10,000	6.9	4.6	1.3
$10,000 to $20,000	7.7	0.7	4.7
$20,000 to $30,000	4.4	0.1	4.2
$30,000 to $40,000	0.3	(2)	0.3
$40,000 to $50,000	0.1	(2)	0.1
$50,000 to $75,000	(2)	(2)	(2)
$75,000 to $100,000	0.0	0.0	0.0
$100,000 to $200,000	0.0	0.0	0.0
$200,000 and over	0.0	0.0	0.0
Total, all taxpayers:	19.4	5.5	10.5

Details may not add to total due to rounding.

[1] The income concept used to place tax returns into income categories is adjusted gross income plus [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers' compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1999 levels.

Source: Staff of the Joint Committee on Taxation.

Analysis

The EIC has two main sources of complexity. The first source of complexity is in determining whether or not a child is a qualifying child for purposes of claiming the EIC. While in most family situations the determination of eligibility is straightforward, in other situations complex living arrangements make it difficult to determine whether a child is eligible for a credit with respect to a particular taxpayer. In certain cases, more than one taxpayer would appear to be able to claim the EIC with respect to a particular child - in such cases, however, only the taxpayer with the higher AGI is allowed to claim the credit. In order for the taxpayer with the lower AGI to know not to claim the credit, such taxpayer needs to know that the child is EIC-eligible with respect to another taxpayer, and know that such taxpayer has a higher AGI. While in some cases these determinations may be easily made, such as when all the relevant persons are living in the same household. However, such situations often lead to both taxpayers claiming the credit, or the wrong taxpayer claiming the credit.

The second source of complexity with respect to the EIC is the calculation of the credit. A taxpayer's credit is based on his or her earned income, and may also be affected by amounts of unearned income. In determining earned income, a taxpayer must include non-taxable earned income, such as salary deferrals, excludable dependent care benefits, housing allowances, etc. Determining the value of these benefits may be difficult. While earned income is used to determine the credit during the phase-in of the credit, a taxpayer must include his or her unearned income to determine the credit amount if he or she is in the phase-out range of the credit. Using one income measure for the phase-in of the credit and another for the phase-out of the credit might be seen as contributing to some complexity. While the various credit phase-in and phase-out rates may appear to create great complexity, the IRS-provided worksheet and EIC credit table make it possible to determine the credit knowing the amounts of earned and unearned income and the number of qualifying children, but without knowing the phase-in or phase-out rates. Also, as an alternative, the IRS will calculate the amount of the credit for the taxpayer as long as the amount of nontaxable earned income is provided.

I. Estimated Taxes

Present law

Taxpayers whose sole (or primary) form of income is wages generally do not make estimated tax payments, because they generally have sufficient taxes withheld from their wages to cover their tax liability. In fact, many of these individuals have taxes withheld from their wages in excess of their ultimate tax liability. Taxpayers who make estimated tax payments generally receive a significant amount of income from non-wage sources. For tax year 1996, 120.7 million individual income tax returns were filed. Of those returns, 12.3 million reflected estimated tax payments made for that tax year. Thus, approximately 10 percent of filing units made estimated tax payments, while 90 percent did not. One goal of the estimated tax system is to ensure that the amount of estimated tax payments made (including any income tax withholding) closely approximates the actual tax liability that a taxpayer will owe. Taxpayers who do not pay enough estimated tax are liable for a penalty for failing to do so. In 1996, the Internal Revenue Service asserted estimated tax penalties, in total, of over $1 billion against approximately 5.6 million taxpayers.

Analysis

The estimated tax rules can require taxpayers to perform a variety of calculations. These calculations are shown on Form 2210, Underpayment of Estimated Tax by Individuals, Estates and Trusts, which is reproduced in Appendix C. The following are principal sources of complexity in the estimated tax rules.

Underpayment periods.–Section 6654(b)(1) defines "underpayment" as the amount of an installment due over the amount of any installment paid (including withholding) on or before the due date of the installment. In determining an underpayment penalty for a calendar year taxpayer, the period of underpayment runs for each underpayment from the payment's due date through the earlier of April 15th or the date on which any such portion of the payment is made. (When a payment of estimated tax is made, it is credited against unpaid required installments in the order in which such installments are required to be paid.) Underpayment balances are not cumulative and do not carry over from one estimated tax period to the next; overpayments, however, are applied to successive estimated tax payments. Form 2210, which is used to calculate a taxpayer's underpayment for each estimated tax payment period, requires several calculations, some of which are a result of the present-law definition of "underpayment" and "period of underpayment."

Interest rates.–The underpayment penalty is calculated by applying the underpayment interest rate of section 6621 to the amount of the underpayment for the period of the underpayment. The underpayment interest rate is calculated by adding 3 percentage points to the Federal short-term rate, which is determined by the Secretary for the first month in each calendar quarter. Estimated payments, for a calendar-year individual taxpayer, are due on the 15th day of April, June, September, and January (of the following year). Interest rates, however, change as of the first day of each quarter. Thus, taxpayers may have up to three different interest rates apply to one quarter's underpayment.[40] Depending on the fluctuation of interest rates throughout the year, taxpayers may be required to perform several interest-related calculations when completing Form 2210.

Annualizing income.–The estimated tax rules permit taxpayers to lower or eliminate the amount of one or more estimated tax installments by using the annualized income installment method. Use of this rule allows taxpayers to recognize situations in which their income varied during the year because, for example, the taxpayer had unexpected income in a particular quarter or conducted business on a seasonal basis. Taxpayers who annualize their income are required to file Form 2210, regardless of whether the taxpayer is liable for a penalty for underpayment of estimated tax. Calculating estimated tax payments on an annualized basis, however, requires multiple calculations. For example, a taxpayer who annualizes must essentially calculate adjusted gross income and itemized deductions for four different periods throughout the taxable year.

Income shifts and safe harbors.–Taxpayers generally must make estimated tax payments equal to the smaller of: (1) 90 percent of the current year's tax or (2) 100 percent of the prior year's tax. The 100 percent of prior year's tax safe harbor is increased to a higher percentage for any individual with an adjusted gross income in excess of $150,000 as shown on the prior year's tax return ($75,000 for married individuals filing separately). Because prior year's tax numbers generally are available to taxpayers at the start of the preceding tax year (or soon thereafter), this safe harbor generally is less onerous to calculate than one based on current year's tax. However, when a taxpayer has an unexpected (and nonrecurring) increase in income during a taxable year, the taxpayer may not wish to base his or her successive year's estimated tax payments on the unusually high prior year's tax. Consider a taxpayer with an unusual item of income in year 1. The taxpayer would not desire making estimated tax payments for year 2 based on the taxpayer's income in year 1. Thus, this taxpayer would have to make its year 2 estimated tax payments by monitoring current year's income, period by period, to ensure that each payments falls within the current-year-income safe harbor.

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[40] A special rule exists under section 6621(b)(2)(B), which provides that the Federal short-term rate which applies during the third month following the taxable year shall also apply during the first 15 days of the fourth month following such taxable year.

Appendix A: IRS Worksheets and Forms Relating to the Individual Alternative Minimum Tax

Worksheet To See If You Should Fill In Form 6251 – Line 51[1]

(keep for your records)

1.	Enter the amount from Form 1040, line 37	1._______
2.	If you itemized deductions on Schedule A, go to line 3. Otherwise, enter your standard deduction from Form 1040, line 36, and go to line 5	2._______
3.	Enter the **smaller** of the amount on Schedule A, line 4 or 2.5% (.025) of the amount on Form 1040, line 34	3._______
4.	Add lines 9 and 26 of Schedule A and enter the total	4._______
5.	Add lines 1 through 4 above	5._______
6.	Enter: $45,000 if married filing jointing or qualifying widow(er); $22,500 if married filing separately; $33,750 if single or head of household	6._______
7.	Subtract line 6 from line 5. If zero or less, **stop**; you do not need to fill in Form 6251	7._______
8.	Enter: $150,000 if married filing jointly or qualifying widow(er); $75,000 if married filing separately; $112,500 if single or head of household	8._______
9.	Subtract line 8 from line 5. If zero or less, enter -0- here and on line 10 and go to line 11	9._______
10.	Multiply line 9 by 25% (.25) and enter the result but do not enter more than line 6 above	10._______
11.	Add lines 7 and 10. If the total is over: $175,000 if single, married filing jointly, head of household, or qualifying widow(er); $87,500 if married filing separately, **stop** and fill in Form 6251 to see if you owe the alternative minimum tax	11._______
12.	Multiply line 11 by 26% (.26)	12._______

Next: If line 12 if more than the amount on Form 1040, line 40 (excluding any amount from Form 4972), fill in Form 6251 to see if you owe the alternative minimum tax. If line 12 is equal to or less than that amount, **do not** fill in Form 6251.

[1] This worksheet appears in the instructions for Form 1040, the Individual Income Tax Return.

Form **6251** | **Alternative Minimum Tax—Individuals** | OMB No. 1545-0227

Department of the Treasury Internal Revenue Service (99)

▶ See separate instructions.

▶ Attach to Form 1040 or Form 1040NR.

1998 Attachment Sequence No. **32**

Name(s) shown on Form 1040 | Your social security number

Part I Adjustments and Preferences

1	If you itemized deductions on Schedule A (Form 1040), go to line 2. Otherwise, enter your standard deduction from Form 1040, line 36, here and go to line 6	1	
2	Medical and dental. Enter the smaller of Schedule A (Form 1040), line 4 or 2½% of Form 1040, line 34	2	
3	Taxes. Enter the amount from Schedule A (Form 1040), line 9	3	
4	Certain interest on a home mortgage not used to buy, build, or improve your home	4	
5	Miscellaneous itemized deductions. Enter the amount from Schedule A (Form 1040), line 26	5	
6	Refund of taxes. Enter any tax refund from Form 1040, line 10 or line 21	6	( )
7	Investment interest. Enter difference between regular tax and AMT deduction	7	
8	Post-1986 depreciation. Enter difference between regular tax and AMT depreciation	8	
9	Adjusted gain or loss. Enter difference between AMT and regular tax gain or loss	9	
10	Incentive stock options. Enter excess of AMT income over regular tax income	10	
11	Passive activities. Enter difference between AMT and regular tax income or loss	11	
12	Beneficiaries of estates and trusts. Enter the amount from Schedule K-1 (Form 1041), line 9	12	
13	Tax-exempt interest from private activity bonds issued after 8/7/86	13	
14	Other. Enter the amount, if any, for each item below and enter the total on line 14.		
	a Circulation expenditures / h Loss limitations		
	b Depletion / i Mining costs		
	c Depreciation (pre-1987) / j Patron's adjustment		
	d Installment sales / k Pollution control facilities		
	e Intangible drilling costs / l Research and experimental		
	f Large partnerships / m Section 1202 exclusion		
	g Long-term contracts / n Tax shelter farm activities		
	o Related adjustments	14	
15	**Total Adjustments and Preferences.** Combine lines 1 through 14 ▶	15	

Part II Alternative Minimum Taxable Income

16	Enter the amount from Form 1040, **line 37.** If less than zero, enter as a (loss) ▶	16	
17	Net operating loss deduction, if any, from Form 1040, line 21. Enter as a positive amount	17	
18	If Form 1040, line 34, is over $124,500 (over $62,250 if married filing separately), and you itemized deductions, enter the amount, if any, from line 9 of the worksheet for Schedule A (Form 1040), line 28	18	( )
19	Combine lines 15 through 18 ▶	19	
20	Alternative tax net operating loss deduction. See page 7 of the instructions	20	
21	**Alternative Minimum Taxable Income.** Subtract line 20 from line 19. (If married filing separately and line 21 is more than $165,000, see page 7 of the instructions.) ▶	21	

Part III Exemption Amount and Alternative Minimum Tax

22 **Exemption Amount.** (If this form is for a child under age 14, see page 7 of the instructions.)

IF your filing status is . . .	**AND line 21 is not over . . .**	**THEN enter on line 22 . . .**
Single or head of household	$112,500	$33,750
Married filing jointly or qualifying widow(er)	150,000	45,000
Married filing separately	75,000	22,500

If line 21 is over the amount shown above for your filing status, see page 7 of the instructions. — 22

23	Subtract line 22 from line 21. If zero or less, enter -0- here and on lines 26 and 28 ▶	23	
24	If you completed Schedule D (Form 1040), and have an amount on line 25 or line 27 (or would have had an amount on either line if you had completed Part IV) (as refigured for the AMT, if necessary), go to Part IV of Form 6251 to figure line 24. **All others:** If line 23 is $175,000 or less ($87,500 or less if married filing separately), multiply line 23 by 26% (.26). Otherwise, multiply line 23 by 28% (.28) and subtract $3,500 ($1,750 if married filing separately) from the result ▶	24	
25	Alternative minimum tax foreign tax credit. See page 8 of the instructions	25	
26	Tentative minimum tax. Subtract line 25 from line 24 ▶	26	
27	Enter your tax from Form 1040, line 40 (minus any tax from Form 4972 and any foreign tax credit from Form 1040, line 46)	27	
28	**Alternative Minimum Tax.** Subtract line 27 from line 26. If zero or less, enter -0-. Enter here and on Form 1040, line 51 ▶	28	

For Paperwork Reduction Act Notice, see separate instructions. Cat. No. 13600G Form **6251** (1998)

Part IV Line 24 Computation Using Maximum Capital Gains Rates

Caution: *If you did not complete Part IV of Schedule D (Form 1040), complete lines 20 through 27 of Schedule D (as refigured for the AMT, if necessary) before you complete this part.*

29	Enter the amount from line 23			29	
30	Enter the amount from Schedule D (Form 1040), line 27 (as refigured for the AMT, if necessary). See page 8 of the instructions	30			
31	Enter the amount from Schedule D (Form 1040), line 25 (as refigured for the AMT, if necessary). See page 8 of the instructions	31			
32	Add lines 30 and 31	32			
33	Enter the amount from Schedule D (Form 1040), line 22 (as refigured for the AMT, if necessary). See page 8 of the instructions	33			
34	Enter the **smaller** of line 32 or line 33			34	
35	Subtract line 34 from line 29. If zero or less, enter -0-			35	
36	If line 35 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 35 by 26% (.26). Otherwise, multiply line 35 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result ▶			36	
37	Enter the amount from Schedule D (Form 1040), line 36 (as figured for the regular tax)			37	
38	Enter the **smallest** of line 29, line 30, or line 37			38	
39	Multiply line 38 by 10% (.10) ▶			39	
40	Enter the **smaller** of line 29 or line 30			40	
41	Enter the amount from line 38			41	
42	Subtract line 41 from line 40. If zero or less, enter -0-			42	
43	Multiply line 42 by 20% (.20) ▶			43	
44	Enter the amount from line 29			44	
45	Add lines 35, 38, and 42			45	
46	Subtract line 45 from line 44			46	
47	Multiply line 46 by 25% (.25) ▶			47	
48	Add lines 36, 39, 43, and 47			48	
49	If line 29 is \$175,000 or less (\$87,500 or less if married filing separately), multiply line 29 by 26% (.26). Otherwise, multiply line 29 by 28% (.28) and subtract \$3,500 (\$1,750 if married filing separately) from the result			49	
50	Enter the **smaller** of line 48 or line 49 here and on line 24 ▶			50	

Form **8801**

Department of the Treasury
Internal Revenue Service (99)

Credit For Prior Year Minimum Tax—Individuals, Estates, and Trusts

▶ Attach to your tax return.

OMB No. 1545-1073

1998

Attachment Sequence No. 74

Name(s) shown on return | Identifying number

Part I Net Minimum Tax on Exclusion Items

1	Combine lines 16 through 18 of your 1997 Form 6251. Estates and trusts, see instructions	1	
2	Enter adjustments and preferences treated as exclusion items. See instructions	2	
3	Minimum tax credit net operating loss deduction. See instructions	3	( )
4	Combine lines 1, 2, and 3. If zero or less, enter -0- here and on line 15 and go to Part II. If more than $165,000 and you were married filing separately for 1997, see instructions	4	
5	Enter: $45,000 if married filing jointly or qualifying widow(er) for 1997; $33,750 if single or head of household for 1997; or $22,500 if married filing separately for 1997. Estates and trusts, enter $22,500	5	
6	Enter: $150,000 if married filing jointly or qualifying widow(er) for 1997; $112,500 if single or head of household for 1997; or $75,000 if married filing separately for 1997. Estates and trusts, enter $75,000	6	
7	Subtract line 6 from line 4. If zero or less, enter -0- here and on line 8 and go to line 9	7	
8	Multiply line 7 by 25% (.25)	8	
9	Subtract line 8 from line 5. If zero or less, enter -0-. If this form is for a child under age 14, see instructions	9	
10	Subtract line 9 from line 4. If zero or less, enter -0- here and on line 15, and go to Part II. Form 1040NR filers, see instructions	10	
11	If you completed Schedule D (Form 1040 or 1041) for 1997 and had an amount on line 25 or line 27 of Schedule D (Form 1040) (line 24 or line 27 of Schedule D (Form 1041)) or you would have had an amount on either of those lines had you completed Part IV of Schedule D (Form 1040) (or Part V of Schedule D (Form 1041)), go to Part III of Form 8801 to figure the amount to enter on this line. **All others:** Multiply line 10 by 26% (.26) if line 10 is: $175,000 or less if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $87,500 or less if married filing separately for 1997. **Otherwise,** multiply line 10 by 28% (.28) and subtract from the result: $3,500 if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $1,750 if married filing separately for 1997	11	
12	Minimum tax foreign tax credit on exclusion items. See instructions	12	
13	Tentative minimum tax on exclusion items. Subtract line 12 from line 11	13	
14	Enter the amount from your 1997 Form 6251, line 27, or Form 1041, Schedule I, line 41	14	
15	**Net minimum tax on exclusion items.** Subtract line 14 from line 13. If zero or less, enter -0-	15	

Part II Minimum Tax Credit and Carryforward to 1999

16	Enter the amount from your 1997 Form 6251, line 28, or Form 1041, Schedule I, line 42	16	
17	Enter the amount from line 15 above	17	
18	Subtract line 17 from line 16. If less than zero, enter as a negative amount	18	
19	**1997 minimum tax credit carryforward.** Enter the amount from your 1997 Form 8801, line 26	19	
20	Enter the total of your 1997 unallowed nonconventional source fuel credit and 1997 unallowed qualified electric vehicle credit. See instructions	20	
21	Combine lines 18, 19, and 20. If zero or less, **stop here** and see instructions	21	
22	Enter your 1998 regular income tax liability minus allowable credits. See instructions	22	
23	Enter the amount from your 1998 Form 6251, line 26, or 1998 Form 1041, Schedule I, line 37	23	
24	Subtract line 23 from line 22. If zero or less, enter -0-	24	
25	**Minimum tax credit.** Enter the **smaller** of line 21 or line 24. Also enter this amount on the appropriate line of your 1998 tax return. See instructions	25	
26	**Minimum tax credit carryforward to 1999.** Subtract line 25 from line 21. See instructions	26	

Part III **Line 11 Computation Using Maximum Capital Gains Rates**

Caution: *If you are an individual and you did not complete Part IV of your 1997 Schedule D (Form 1040), complete lines 20 through 27 of that Schedule D before completing this part. For an estate or trust that did not complete Part V of the 1997 Schedule D (Form 1041), complete lines 19 through 27 of that Schedule D before completing this part.*

27	Enter the amount from line 10	27	
28	Enter the amount from your 1997 Schedule D (Form 1040 or 1041), line 27 — 28		
29	Enter the amount from your 1997 Schedule D (Form 1040), line 25, (or 1997 Schedule D (Form 1041), line 24) — 29		
30	Add lines 28 and 29 — 30		
31	Enter the amount from your 1997 Schedule D (Form 1040), line 22, (or 1997 Schedule D (Form 1041), line 21) — 31		
32	Enter the **smaller** of line 30 or line 31	32	
33	Subtract line 32 from line 27. If zero or less, enter -0-	33	
34	Multiply line 33 by 26% (.26) if line 33 is: $175,000 or less if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $87,500 or less if married filing separately for 1997. **Otherwise,** multiply line 33 by 28% (.28) and subtract from the result: $3,500 if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $1,750 if married filing separately for 1997 ▶	34	
35	Enter the amount from your 1997 Schedule D (Form 1040 or 1041), line 36. If you did not complete Part IV of your 1997 Schedule D (Form 1040) (Part V of the 1997 Schedule D (Form 1041) for an estate or trust), enter -0-	35	
36	Enter the **smallest** of line 27, line 28, or line 35	36	
37	Multiply line 36 by 10% (.10) ▶	37	
38	Enter the **smaller** of line 27 or line 28	38	
39	Enter the amount from line 36	39	
40	Subtract line 39 from line 38. If zero or less, enter -0-	40	
41	Multiply line 40 by 20% (.20) ▶	41	
42	Enter the amount from line 27	42	
43	Add lines 33, 36, and 40	43	
44	Subtract line 43 from line 42	44	
45	Multiply line 44 by 25% (.25) ▶	45	
46	Add lines 34, 37, 41, and 45	46	
47	Multiply line 27 by 26% (.26) **if** line 27 is: $175,000 or less if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $87,500 or less if married filing separately for 1997. **Otherwise,** multiply line 27 by 28% (.28) and subtract from the result: $3,500 if single, head of household, married filing jointly, qualifying widow(er), or an estate or trust for 1997; or $1,750 if married filing separately for 1997 ▶	47	
48	Enter the **smaller** of line 46 or line 47 here and on line 11	48	

Proposed 1998 Child Credit Worksheet

The worksheet on the following page was proposed by the IRS to reflect the law as in effect before the amendments made by section 2001 of the Tax and Trade Relief Extension Act of 1998 ("the 1998 Act"). Section 2001 of the 1998 Act allowed the nonrefundable credits against the entire regular tax for the 1998 taxable year. The worksheet that was issued by the IRS subsequent to this legislation deleted lines 12 through 22 on the worksheet because the minimum tax no longer limited the credits for the 1998 taxable year.

Presumably, the IRS will return to a worksheet similar to what follows for taxable years after 1998 when the provision in section 2001 no longer applies.

Do Not File

Child Tax Credit Worksheet—Line 43

▶ Keep for your records.

1.

IF you have...	THEN enter...	IF you have...	THEN enter...
One qualifying child	$400	Three qualifying children	$1,200
Two qualifying children	800	Four qualifying children	1,600

1. ______

If you have **five or more** qualifying children, multiply $400 by the number of children and enter the result on line 1.

2. Are you filing **Form 2555, 2555-EZ,** or **4563,** or are you excluding income from Puerto Rico? To find out what these forms are used for, see page 25.

☐ **No.** Enter the amount from Form 1040, line 34.
☐ **Yes.** Enter your **modified AGI** (see page 25). 2. ______

3. Enter: $110,000 if married filing jointly; $75,000 if single, head of household, or qualifying widow(er); $55,000 if married filing separately 3. ______

4. Is line 2 above more than line 3?

☐ **No.** Skip lines 4 and 5, enter -0- on line 6, and go to line 7.
☐ **Yes.** Subtract line 3 from line 2 4. ______

5. Divide line 4 by $1,000. If the result is not a whole number, round it up to the next higher whole number (for example, round 0.01 to 1) 5. ______

6. Multiply $50 by the number on line 5 6. ______

7. Subtract line 6 from line 1. If zero or less, **stop here;** you **cannot** take this credit 7. ______

8. Enter the amount from Form 1040, line 40 8. ______

9. Is line 1 above more than $800?

☐ **No.** Add the amounts from Form 1040, lines 41, 42, and 44. Enter the total.
☐ **Yes.** Enter the amount from the worksheet on page 27. 9. ______

10. Subtract line 9 above from line 8 10. ______

11. Enter the **smaller** of line 7 or line 10 ▶ 11. ______

12. Are you reporting tax-exempt interest on Form 1040, line 8b, or are you claiming a net operating loss deduction on Form 1040, line 21?

☐ **No.** Enter the amount from Form 1040, line 22.
☐ **Yes.** Enter the total of the amount from Form 1040, line 22, plus any tax-exempt interest from private activity bonds issued after August 7, 1986, and net operating loss deduction. 12. ______

13. Are you filing **Schedule C, C-EZ, D, E,** or **F?** To find out what these schedules are used for, see page 25.

☐ **No.** Go to line 14.
☐ **Yes.** Complete **Form 6251** through line 24, enter that amount on line 20 below, and go to line 21.

14. Is line 12 above more than: $45,000 if married filing jointly or qualifying widow(er); $33,750 if single or head of household; $22,500 if married filing separately?

☐ **No.** Skip lines 15 through 21 and go to line 22.
☐ **Yes.** Go to line 15.

15. Is line 12 more than: $150,000 if married filing jointly or qualifying widow(er); $112,000 if single or head of household; $75,000 if married filing separately?

☐ **No.** Go to line 16.
☐ **Yes.** Complete **Form 6251** through line 24, enter that amount on line 20 below, and go to line 21.

16. Enter: $45,000 if married filing jointly or qualifying widow(er); $33,750 if single or head of household; $22,500 if married filing separately 16. ______

17. Subtract line 16 from line 12 17. ______

18. Multiply line 17 by 26% (.26) 18. ______

19. Subtract line 18 from line 10. If zero or less, enter -0- 19. ______

20. Is line 11 more than line 19?

☐ **No.** Skip lines 20 and 21 and go to line 22.
☐ **Yes.** Complete **Form 6251** through line 24 and enter that amount here 20. ______

21. Subtract line 20 from line 10. If zero or less, enter -0- 21. ______

22. **Child tax credit.**

- If you checked "No" on line 14 or line 20, enter the amount from line 11 here and Form 1040, line 43
- If you checked "Yes" on line 14 or line 20, enter the **smaller** of line 11 or line 21 here and on Form 1040, line 43. If line 21 is the smaller amount, enter "AMT" on the dotted line next to line 43 22. ______

Appendix B: IRS Forms Relating to Capital Gains and Losses

SCHEDULE D (Form 1040)
Department of the Treasury Internal Revenue Service (99)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).
▶ Use Schedule D-1 for more space to list transactions for lines 1 and 8.

OMB No. 1545-0074
1998
Attachment Sequence No. 12

Name(s) shown on Form 1040 | Your social security number

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-6)	(e) Cost or other basis (see page D-6)	(f) GAIN or (LOSS) Subtract (e) from (d)
1					
2 Enter your short-term totals, if any, from Schedule D-1, line 2 2					
3 **Total short-term sales price amounts.** Add column (d) of lines 1 and 2 . . . 3					
4 Short-term gain from Form 6252 and short-term gain or (loss) from Forms 4684, 6781, and 8824 . . . 4					
5 Net short-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . 5					
6 Short-term capital loss carryover. Enter the amount, if any, from line 8 of your 1997 Capital Loss Carryover Worksheet . . . 6					( )
7 **Net short-term capital gain or (loss).** Combine lines 1 through 6 in column (f) . . . ▶ 7					

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-6)	(e) Cost or other basis (see page D-6)	(f) GAIN or (LOSS) Subtract (e) from (d)	(g) 28% RATE GAIN or (LOSS) * (see instr. below)
8						
9 Enter your long-term totals, if any, from Schedule D-1, line 9 9						
10 **Total long-term sales price amounts.** Add column (d) of lines 8 and 9 . . . 10						
11 Gain from Form 4797, Part I; long-term gain from Forms 2439 and 6252; and long-term gain or (loss) from Forms 4684, 6781, and 8824 . . . 11						
12 Net long-term gain or (loss) from partnerships, S corporations, estates, and trusts from Schedule(s) K-1 . . . 12						
13 Capital gain distributions. See page D-2 . . . 13						
14 Long-term capital loss carryover. Enter in both columns (f) and (g) the amount, if any, from line 13 of your 1997 Capital Loss Carryover Worksheet . . . 14					( )	( )
15 Combine lines 8 through 14 in column (g) . . . 15						
16 **Net long-term capital gain or (loss).** Combine lines 8 through 14 in column (f) . . . ▶ 16						

Next: Go to Part III on the back.

***28% Rate Gain or Loss** includes all "collectibles gains and losses" (as defined on page D-6) and up to 50% of the eligible gain on qualified small business stock (see page D-5).

For Paperwork Reduction Act Notice, see Form 1040 instructions. Cat. No. 11338H **Schedule D (Form 1040) 1998**

Part III Summary of Parts I and II

17 Combine lines 7 and 16. If a loss, go to line 18. If a gain, enter the gain on Form 1040, line 13 | 17 |

Next: Complete Form 1040 through line 39. Then, go to **Part IV** to figure your tax if:

- Both lines 16 and 17 are gains, and
- Form 1040, line 39, is more than zero.

18 If line 17 is a loss, enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses:

- The loss on line 17; or
- ($3,000) or, if married filing separately, ($1,500) . . . | 18 | ( )

Next: Complete Form 1040 through line 37. Then, complete the **Capital Loss Carryover Worksheet** on page D-6 if:

- The loss on line 17 exceeds the loss on line 18, or
- Form 1040, line 37, is a loss.

Part IV Tax Computation Using Maximum Capital Gains Rates

19	Enter your taxable income from Form 1040, line 39 . . .		19	
20	Enter the **smaller** of line 16 or line 17 of Schedule D . . .	20		
21	If you are filing Form 4952, enter the amount from Form 4952, line 4e	21		
22	Subtract line 21 from line 20. If zero or less, enter -0- . . .	22		
23	Combine lines 7 and 15. If zero or less, enter -0- . . .	23		
24	Enter the **smaller** of line 15 or line 23, but not less than zero . . .	24		
25	Enter your unrecaptured section 1250 gain, if any (see page D-7) .	25		
26	Add lines 24 and 25 . . .	26		
27	Subtract line 26 from line 22. If zero or less, enter -0- . . .		27	
28	Subtract line 27 from line 19. If zero or less, enter -0- . . .		28	
29	Enter the **smaller** of: • The amount on line 19, **or** • $25,350 if single; $42,350 if married filing jointly or qualifying widow(er); $21,175 if married filing separately; or $33,950 if head of household . . .		29	
30	Enter the **smaller** of line 28 or line 29 . . .		30	
31	Subtract line 22 from line 19. If zero or less, enter -0- . . .		31	
32	Enter the **larger** of line 30 or line 31 . . .		32	
33	Figure the tax on the amount on line 32. Use the Tax Table or Tax Rate Schedules, whichever applies . . . ▶		33	
34	Enter the amount from line 29 . . .		34	
35	Enter the amount from line 28 . . .		35	
36	Subtract line 35 from line 34. If zero or less, enter -0- . . .		36	
37	Multiply line 36 by 10% (.10) . . . ▶		37	
38	Enter the **smaller** of line 19 or line 27 . . .		38	
39	Enter the amount from line 36 . . .		39	
40	Subtract line 39 from line 38 . . .		40	
41	Multiply line 40 by 20% (.20) . . . ▶		41	
42	Enter the **smaller** of line 22 or line 25 . . .		42	
43	Add lines 22 and 32 . . .	43		
44	Enter the amount from line 19 . . .	44		
45	Subtract line 44 from line 43. If zero or less, enter -0- . . .		45	
46	Subtract line 45 from line 42. If zero or less, enter -0- . . .		46	
47	Multiply line 46 by 25% (.25) . . . ▶		47	
48	Enter the amount from line 19 . . .		48	
49	Add lines 32, 36, 40, and 46 . . .		49	
50	Subtract line 49 from line 48 . . .		50	
51	Multiply line 50 by 28% (.28) . . . ▶		51	
52	Add lines 33, 37, 41, 47, and 51 . . .		52	
53	Figure the tax on the amount on line 19. Use the Tax Table or Tax Rate Schedules, whichever applies		53	
54	**Tax on taxable income (including capital gains).** Enter the **smaller** of line 52 or line 53 here and on Form 1040, line 40 . . . ▶		54	

SCHEDULE D (Form 1040)

Department of the Treasury
Internal Revenue Service (98)

Capital Gains and Losses

▶ Attach to Form 1040. ▶ See Instructions for Schedule D (Form 1040).

▶ Use lines 20 and 22 for more space to list transactions for lines 1 and 9.

OMB No. 1545-0074

1996

Attachment Sequence No. 12

Name(s) shown on Form 1040

Your social security number

Part I Short-Term Capital Gains and Losses—Assets Held One Year or Less

	(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
1							
2	Enter your short-term totals, if any, from line 21		2				
3	**Total short-term sales price amounts.** Add column (d) of lines 1 and 2 . . .		3				
4	Short-term gain from Forms 2119 and 6252, and short-term gain or loss from Forms 4684, 6781, and 8824				4		
5	Net short-term gain or loss from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				5		
6	Short-term capital loss carryover. Enter the amount, if any, from line 9 of your 1995 Capital Loss Carryover Worksheet				6		
7	Add lines 1 through 6 in columns (f) and (g)				7	( )	
8	**Net short-term capital gain or (loss).** Combine columns (f) and (g) of line 7 . . . . . . ▶					8	

Part II Long-Term Capital Gains and Losses—Assets Held More Than One Year

	(a)	(b)	(c)	(d)	(e)	(f)	(g)
9							
10	Enter your long-term totals, if any, from line 23		10				
11	**Total long-term sales price amounts.** Add column (d) of lines 9 and 10 . . .		11				
12	Gain from Form 4797; long-term gain from Forms 2119, 2439, and 6252; and long-term gain or loss from Forms 4684, 6781, and 8824				12		
13	Net long-term gain or loss from partnerships, S corporations, estates, and trusts from Schedule(s) K-1				13		
14	Capital gain distributions				14		
15	Long-term capital loss carryover. Enter the amount, if any, from line 14 of your 1995 Capital Loss Carryover Worksheet				15		
16	Add lines 9 through 15 in columns (f) and (g)				16	( )	
17	**Net long-term capital gain or (loss).** Combine columns (f) and (g) of line 16 . . . . . . ▶					17	

Part III Summary of Parts I and II

18	Combine lines 8 and 17. If a loss, go to line 19. If a gain, enter the gain on Form 1040, line 13. **Note:** *If both lines 17 and 18 are gains, see the* ***Capital Gain Tax Worksheet*** *on page 23* . .	18	
19	If line 18 is a loss, enter here and as a (loss) on Form 1040, line 13, the **smaller** of these losses:		
a	The loss on line 18; **or**		
b	($3,000) or, if married filing separately, ($1,500)	19	( )
	Note: *See the* ***Capital Loss Carryover Worksheet*** *on page D-3 if the loss on line 18 exceeds the loss on line 19* ***or*** *if Form 1040, line 35, is a loss.*		

Name(s) shown on Form 1040. Do not enter name and social security number if shown on other side. | Your social security number

Part IV Short-Term Capital Gains and Losses—Assets Held One Year or Less *(Continuation of Part I)*

(a) Description of property (Example: 100 sh. XYZ Co.)	(b) Date acquired (Mo., day, yr.)	(c) Date sold (Mo., day, yr.)	(d) Sales price (see page D-3)	(e) Cost or other basis (see page D-3)	(f) LOSS If (e) is more than (d), subtract (d) from (e)	(g) GAIN If (d) is more than (e), subtract (e) from (d)
20						
21 Short-term totals. Add columns (d), (f), and (g) of line 20. Enter here and on line 2 . . . 21						

Part V Long-Term Capital Gains and Losses—Assets Held More Than One Year *(Continuation of Part II)*

(a)	(b)	(c)	(d)	(e)	(f)	(g)
22						
23 Long-term totals. Add columns (d), (f), and (g) of line 22. Enter here and on line 10 . . . 23						

Use this worksheet to figure your tax **only** if **(a)** you are filing Schedule D and both lines 17 and 18 of Schedule D are gains, or **(b)** you reported capital gain distributions directly on Form 1040, line 13, **and:**

Your filing status is: AND	Form 1040, line 37, is over:	Your filing status is: AND	Form 1040, line 37, is over:
Single	$58,150	Head of household . . .	$83,050
Married filing jointly or Qualifying widow(er) . .	$96,900	Married filing separately	$48,450

1.	Enter the amount from Form 1040, line 37		**1.** ______
2.	If you are filing Schedule D, enter the **smaller** of Schedule D, line 17 or line 18. Otherwise, enter the capital gain distributions reported on Form 1040, line 13	**2.** ______	
3.	If you are filing Form 4952, enter the amount from Form 4952, line 4e	**3.** ______	
4.	Subtract line 3 from line 2. If zero or less, **stop;** you **cannot** use this worksheet to figure your tax. Instead, use the Tax Table or Tax Rate Schedules, whichever applies		**4.** ______
5.	Subtract line 4 from line 1		**5.** ______
6.	Enter $40,100 ($24,000 if single; $20,050 if married filing separately; $32,150 if head of household)		**6.** ______
7.	Enter the **larger** of line 5 or line 6		**7.** ______
8.	Subtract line 7 from line 1		**8.** ______
9.	Figure the tax on the amount on line 7. Use the Tax Table or Tax Rate Schedules, whichever applies		**9.** ______
10.	Multiply line 8 by 28% (.28)		**10.** ______
11.	Add lines 9 and 10		**11.** ______
12.	Figure the tax on the amount on line 1. Use the Tax Table or Tax Rate Schedules, whichever applies		**12.** ______
13.	**Tax.** Enter the **smaller** of line 11 or line 12 here and on Form 1040, line 38		**13.** ______

Appendix C: IRS Form Relating to Estimated Taxes

Form **2210**

Department of the Treasury
Internal Revenue Service

Underpayment of Estimated Tax by Individuals, Estates, and Trusts

▶ See separate instructions.

▶ Attach to Form 1040, 1040A, 1040NR, 1040NR-EZ, or 1041.

OMB No. 1545-0140

1998

Attachment Sequence No. 06

Name(s) shown on tax return | Identifying number

Note: *In most cases, you* **do not** *need to file Form 2210. The IRS will figure any penalty you owe and send you a bill. File Form 2210* **only** *if one or more boxes in Part I apply to you. If you do not need to file Form 2210, you still may use it to figure your penalty. Enter the amount from Part III, line 21, or Part IV, line 35, on the penalty line of your return, but* **do not** *attach Form 2210.*

Part I **Reasons for Filing**—If 1a, 1b, or 1c below applies to you, you may be able to lower or eliminate your penalty. But you MUST check the boxes that apply and file Form 2210 with your tax return. If 1d below applies to you, check that box and file Form 2210 with your tax return.

1 Check whichever boxes apply (if none apply, see the **Note** above):

a ☐ You request a **waiver.** In certain circumstances, the IRS will waive all or part of the penalty. See **Waiver of Penalty** on page 2 of the instructions.

b ☐ You use the **annualized income installment method.** If your income varied during the year, this method may reduce the amount of one or more required installments. See page 4 of the instructions.

c ☐ You had Federal income tax withheld from wages and, for estimated tax purposes, you treat the withheld tax as paid on the dates it was actually withheld, instead of in equal amounts on the payment due dates. See the instructions for line 23 on page 3.

d ☐ Your required annual payment (line 14 below) is based on your 1997 tax and you filed or are filing a joint return for either 1997 or 1998 but not for both years.

Part II **Required Annual Payment**

2	Enter your 1998 tax after credits (see page 2 of the instructions)			2	
3	Other taxes (see page 2 of the instructions)			3	
4	Add lines 2 and 3			4	
5	Earned income credit	5			
6	Additional child tax credit	6			
7	Credit for Federal tax paid on fuels	7			
8	Add lines 5, 6, and 7			8	
9	Current year tax. Subtract line 8 from line 4			9	
10	Multiply line 9 by 90% (.90)	10			
11	Withholding taxes. **Do not** include any estimated tax payments on this line (see page 2 of the instructions)			11	
12	Subtract line 11 from line 9. If less than $1,000, stop here; **do not** complete or file this form. You do not owe the penalty			12	
13	Enter the tax shown on your 1997 tax return. **Caution:** *See page 2 of the instructions*			13	
14	**Required annual payment.** Enter the **smaller** of line 10 or line 13			14	

Note: *If line 11 is equal to or more than line 14, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked box 1d above.*

Part III **Short Method (Caution:** *See page 2 of the instructions to find out if you can use the short method. If you checked box* **1b** *or* **1c** *in Part I, skip this part and go to Part IV.***)**

15	Enter the amount, if any, from line 11 above	15			
16	Enter the total amount, if any, of estimated tax payments you made	16			
17	Add lines 15 and 16			17	
18	**Total underpayment for year.** Subtract line 17 from line 14. If zero or less, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked box 1d above			18	
19	Multiply line 18 by .05043			19	
20	• If the amount on line 18 was paid **on or after** 4/15/99, enter -0-. • If the amount on line 18 was paid **before** 4/15/99, make the following computation to find the amount to enter on line 20. Amount on line 18 × Number of days paid before 4/15/99 × .00019			20	
21	**PENALTY.** Subtract line 20 from line 19. Enter the result here and on Form 1040, line 69; Form 1040A, line 44; Form 1040NR, line 68; Form 1040NR-EZ, line 27; or Form 1041, line 26 ▶			21	

For Paperwork Reduction Act Notice, see page 1 of separate instructions. Cat. No. 11744P Form **2210** (1998)

Part IV **Regular Method** (See page 3 of the instructions if you are filing Form 1040NR or 1040NR-EZ.)

Section A—Figure Your Underpayment		Payment Due Dates (a) 4/15/98	(b) 6/15/98	(c) 9/15/98	(d) 1/15/99
22 **Required installments.** If box 1b applies, enter the amounts from Schedule AI, line 26. Otherwise, enter ¼ of line 14, Form 2210, in each column	22				
23 Estimated tax paid and tax withheld (see page 3 of the instructions). For column (a) only, also enter the amount from line 23 on line 27. If line 23 is equal to or more than line 22 for all payment periods, stop here; you do not owe the penalty. Do not file Form 2210 unless you checked a box in Part I	23				
Complete lines 24 through 30 of one column before going to the next column. **24** Enter amount, if any, from line 30 of previous column	24				
25 Add lines 23 and 24	25				
26 Add amounts on lines 28 and 29 of the previous column	26				
27 Subtract line 26 from line 25. If zero or less, enter -0-. For column (a) only, enter the amount from line 23 .	27				
28 If the amount on line 27 is zero, subtract line 25 from line 26. Otherwise, enter -0-	28				
29 **Underpayment.** If line 22 is equal to or more than line 27, subtract line 27 from line 22. Then go to line 24 of next column. Otherwise, go to line 30 . . ▶	29				
30 Overpayment. If line 27 is more than line 22, subtract line 22 from line 27. Then go to line 24 of next column	30				

Section B—Figure the Penalty (Complete lines 31 through 34 of one column before going to the next column.)

Rate Period 1		4/15/98	6/15/98	9/15/98	
April 16, 1998—December 31, 1998 **31** Number of days FROM the date shown above line 31 TO the date the amount on line 29 was paid **or** 12/31/98, whichever is earlier	31	*Days:*	*Days:*	*Days:*	
32 Underpayment on line 29 (see page 3 of the instructions) × Number of days on line 31 / 365 × .08 ▶	32	$	$	$	

Rate Period 2		12/31/98	12/31/98	12/31/98	1/15/99
January 1, 1999—April 15, 1999 **33** Number of days FROM the date shown above line 33 TO the date the amount on line 29 was paid **or** 4/15/99, whichever is earlier	33	*Days:*	*Days:*	*Days:*	*Days:*
34 Underpayment on line 29 (see page 3 of the instructions) × Number of days on line 33 / 365 × .07 ▶	34	$	$	$	$

35 **PENALTY.** Add all amounts on lines 32 and 34 in all columns. Enter the total here and on Form 1040, line 69; Form 1040A, line 44; Form 1040NR, line 68; Form 1040NR-EZ, line 27; or Form 1041, line 26 . . . . ▶ **35** $

Schedule AI—Annualized Income Installment Method (see pages 4 and 5 of the instructions)

Estates and trusts, **do not** use the period ending dates shown to the right. Instead, use the following: 2/28/98, 4/30/98, 7/31/98, and 11/30/98.		(a) 1/1/98–3/31/98	(b) 1/1/98–5/31/98	(c) 1/1/98–8/31/98	(d) 1/1/98–12/31/98
Part I — Annualized Income Installments Caution: *Complete lines 20–26 of one column before going to the next column*					
1 Enter your adjusted gross income for each period (see instructions). (Estates and trusts, enter your taxable income without your exemption for each period.)	1				
2 Annualization amounts. (Estates and trusts, see instructions.)	2	4	2.4	1.5	1
3 Annualized income. Multiply line 1 by line 2	3				
4 Enter your itemized deductions for the period shown in each column. If you do not itemize, enter -0- and skip to line 7. (Estates and trusts, enter -0-, skip to line 9, and enter the amount from line 3 on line 9.)	4				
5 Annualization amounts	5	4	2.4	1.5	1
6 Multiply line 4 by line 5 (see instructions if line 3 is more than $62,250)	6				
7 In each column, enter the full amount of your standard deduction from Form 1040, line 36, or Form 1040A, line 21 (Form 1040NR or 1040NR-EZ filers, enter -0-. **Exception:** Indian students and business apprentices, enter standard deduction from Form 1040NR, line 35 or Form 1040NR-EZ, line 11.)	7				
8 Enter the **larger** of line 6 or line 7	8				
9 Subtract line 8 from line 3	9				
10 In each column, multiply $2,700 by the total number of exemptions claimed (see instructions if line 3 is more than $93,400). (Estates and trusts and Form 1040NR or 1040NR-EZ filers, enter the exemption amount shown on your tax return.)	10				
11 Subtract line 10 from line 9	11				
12 Figure your tax on the amount on line 11 (see instructions)	12				
13 Form 1040 filers only, enter your self-employment tax from line 35 below	13				
14 Enter other taxes for each payment period (see instructions)	14				
15 Total tax. Add lines 12, 13, and 14	15				
16 For each period, enter the same type of credits as allowed on Form 2210, lines 2, 5, 6, and 7 (see instructions)	16				
17 Subtract line 16 from line 15. If zero or less, enter -0-	17				
18 Applicable percentage	18	22.5%	45%	67.5%	90%
19 Multiply line 17 by line 18	19				
20 Add the amounts in all previous columns of line 26	20				
21 Subtract line 20 from line 19. If zero or less, enter -0-	21				
22 Enter ¼ of line 14 on page 1 of Form 2210 in each column	22				
23 Enter amount from line 25 of the previous column of this schedule	23				
24 Add lines 22 and 23 and enter the total	24				
25 Subtract line 21 from line 24. If zero or less, enter -0-	25				
26 Enter the **smaller** of line 21 or line 24 here and on Form 2210, line 22 ▶	26				
Part II — Annualized Self-Employment Tax					
27a Net earnings from self-employment for the period (see instructions)	27a				
b Annualization amounts	27b	4	2.4	1.5	1
c Multiply line 27a by line 27b	27c				
28 Social security tax limit	28	$68,400	$68,400	$68,400	$68,400
29 Enter actual wages for the period subject to social security tax or the 6.2% portion of the 7.65% railroad retirement (tier 1) tax	29				
30 Annualization amounts	30	4	2.4	1.5	1
31 Multiply line 29 by line 30	31				
32 Subtract line 31 from line 28. If zero or less, enter -0-	32				
33 Multiply the smaller of line 27c or line 32 by .124	33				
34 Multiply line 27c by .029	34				
35 Add lines 33 and 34. Enter the result here and on line 13 above ▶	35				