Joint Committee on Taxation
May 15, 2001
JCX-45-01

MODIFICATIONS TO THE CHAIRMAN'S MARK FOR THE "RESTORING EARNINGS TO LIFT INDIVIDUALS AND EMPOWER FAMILIES ACT OF 2001"

The following modifications would be made to the Chairman's mark of the "Restoring Earnings to Lift Individuals and Empower Families Act of 2001":

A. Modifications to Provision in the Chairman's Mark

Education incentives

The modification would allow a credit for interest paid on qualified education loans during the first 60 months in which interest payments are required. The maximum credit available would be $500.

The credit would be phased-out for single taxpayers with modified adjusted gross income between $35,000 and $45,000 and for married taxpayers filing joint returns with modified adjusted gross income between $70,000 and $90,000. These income phase-out ranges would be adjusted annually for inflation.

A taxpayer taking the credit in a taxable year for payment of interest on a qualified education loan would not be allowed a student loan interest deduction in such taxable year. Similarly, if the taxpayer took a deduction, the taxpayer would not qualify for the credit.

The proposal would be effective for taxable years beginning after December 31, 2008.

B. Additional Provisions

The following provisions would be added to the Chairman's mark:

1. Estate, gift, and generation-skipping transfer tax provisions

(a) Expand availability of installment payment of estate tax for estates of decedents with an interest in certain closely-held businesses

Present Law

Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely-held business in two or more annual installments (but no more than 10). An estate is eligible for payment of estate tax in installments if the value of the decedent's interest in a closely-held business exceeds 35 percent of the decedent's adjusted gross estate (i.e., the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax.[1] A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998) in taxable value of a closely-held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely-held business in excess of $1 million is equal to 45 percent of the rate applicable to underpayments of tax under section 6621 (i.e., 45 percent of the Federal short-term rate plus 3 percentage points). Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

For purposes of these rules, an interest in a closely-held business is: (1) an interest as a proprietor in a sole proprietorship, (2) an interest as a partner in a partnership carrying on a trade or business if 20 percent or more of the total capital interest of such partnership is included in the decedent's gross estate or the partnership had 15 or fewer partners, and (3) stock in a corporation carrying on a trade or business if 20 percent or more of the value of the voting stock of the corporation is included in the decedent's gross estate or such corporation had 15 or fewer shareholders. The decedent may own the interest directly or, in certain cases, ownership may be indirect, through a holding company. If ownership is through a holding company, the stock must be non-readily tradable. If stock in a holding company is treated as business company stock for purposes of the installment payment provisions, the 5-year deferral for principal and the 2-percent interest rate do not apply. The value of any interest in a closely-held business does not include the value of that portion of such interest attributable to passive assets held by such business.

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[1] For example, assume estate tax is due in 2001. If interest only is paid each year for the first five years (2001 through 2005), and if 10 installments of both principal and interest are paid for the 10 years thereafter (2006 through 2015), then payment of estate tax would be extended by 14 years from the original due date of 2001.

Description of Proposal

The proposal would expand availability of the installment payment provisions by providing that an estate of a decedent with an interest in a qualifying lending and financing business is eligible for installment payment of estate tax only over five years.

Effective Date

The proposal would be effective for decedents dying after December 31, 2001.

(b) Clarify availability of installment payment of estate tax for estates of decedents with an interest in a closely-held business

Present Law

Under present law, the estate tax generally is due within nine months of a decedent's death. However, an executor generally may elect to pay estate tax attributable to an interest in a closely-held business in two or more annual installments (but no more than 10). An estate is eligible for payment of estate tax in installments if the value of the decedent's interest in a closely-held business exceeds 35 percent of the decedent's adjusted gross estate (i.e., the gross estate less certain deductions). If the election is made, the estate may defer payment of principal and pay only interest for the first five years, followed by up to 10 annual installments of principal and interest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax.[2] A special two-percent interest rate applies to the amount of deferred estate tax attributable to the first $1 million (adjusted annually for inflation occurring after 1998) in taxable value of a closely-held business. The interest rate applicable to the amount of estate tax attributable to the taxable value of the closely-held business in excess of $1 million is equal to 45 percent of the rate applicable to underpayments of tax under section 6621 (i.e., 45 percent of the Federal short-term rate plus two percentage points). Interest paid on deferred estate taxes is not deductible for estate or income tax purposes.

For purposes of these rules, an interest in a closely-held business is: (1) an interest as a proprietor in a sole proprietorship, (2) an interest as a partner in a partnership carrying on a trade or business if 20 percent or more of the total capital interest of such partnership is included in the decedent's gross estate or the partnership had 15 or fewer partners, and (3) stock in a corporation carrying on a trade or business if 20 percent or more of the value of the voting stock of the corporation is included in the decedent's gross estate or such corporation had 15 or fewer shareholders. The decedent may own the interest directly or, in certain cases, ownership may be indirect, through a holding company. If ownership is through a holding company, the stock must not be readily tradable. If stock in a holding company is treated as business company stock for purposes of the installment payment provisions, the five-year deferral for principal and the two-percent interest rate do not apply. The value of any interest in a closely-held business does not

[2] For example, assume estate tax is due in 2001. If interest only is paid each year for the first five years (2001 through 2005), and if 10 installments of both principal and interest are paid for the 10 years thereafter (2006 through 2015), then payment of estate tax would be extended by 14 years from the original due date of 2001.

include the value of that portion of such interest attributable to passive assets held by such business.

Description of Proposal

The proposal would clarify that the installment payment provisions require that only the stock of the holding companies, not that of operating subsidiaries, must be not readily tradable in order to qualify for installment payment of estate tax only over five years.

Effective Date

The proposal would be effective for decedents dying after December 31, 2001.

2. Pension and individual retirement arrangement provisions

(a) Nonresident alien crew members of foreign vessels

Present Law

Generally, compensation for services performed in the United States is treated as U.S. source income. Under a special rule, compensation is not treated as U.S. source income if the compensation is paid for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States. However, this special rule does not apply for purposes of qualified retirement plans, employer-provided group-term life insurance, or employer-provided accident and health plans.

Description of Proposal

Under the proposal, compensation would not be treated as U.S. source income for purposes of qualified retirement plans, employer-provided group-term life insurance, and employer-provided accident and health plans if the compensation is paid for labor or services performed by a nonresident alien in connection with the individual's temporary presence in the United States as a regular member of the crew of a foreign vessel engaged in transportation between the United States and a foreign country or a possession of the United States.

Effective Date

The provision would be effective with respect to plan years beginning after December 31, 2001.

(b) Treatment of contributions to a multiemployer plans

Present Law

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, contributions are deductible for the taxable year of the employer in

which the contributions are made. Under a special rule (section 404(a)(6)), an employer may be deemed to have made a contribution on the last day of the preceding taxable year if the contribution is on account of the preceding taxable year and is made not later than the time prescribed by law for filing the employer's income tax return for that taxable year (including extensions).

A change in method of accounting includes a change in the overall plan of accounting for gross income or deductions or a change in the treatment of any material item used in such overall plan. A material item is any item which involves the proper time for the inclusion of the item in income or taking of a deduction.[3] A change in method of accounting does not include correction of mathematical or posting errors, or errors in the computation of tax liability. Also, a change in method of accounting does not include adjustment of any item of income or deduction which does not involve the proper time for the inclusion of the item of income or the taking of a deduction. A change in method of accounting also does not include a change in treatment resulting from a change in underlying facts.

Description of Proposal

The proposal would provide that a determination of whether a contribution to multiemployer pension plans are on account of a prior year under section 404(a)(6) is not a method of accounting. Thus, any taxpayer that begins to deduct contributions to a multiemployer plan as provided in section 404(a)(6) would not be considered to have changed its method of accounting and would not be subject to an adjustment under section 481. The proposal would be intended to respect, not disturb, the effect of the statute of limitations. The proposal would not be intended to permit, as of the end of the taxable year, aggregate deductions for contributions to a qualified plan in excess of the amounts actually contributed or deemed contributed to the plan by the taxpayer. The Secretary of the Treasury would be authorized to promulgate regulations to clarify that, in the aggregate, no taxpayer would be permitted deductions in excess of amounts actually contributed to a multiemployer plan, taking into account the provisions of section 404(a)(6).

Effective Date

The proposal would be effective on the date of enactment.

[3] Treas. Reg. sec. 1.446-1(e)(2)(ii)(a).