

**TECHNICAL EXPLANATION OF AN AMENDMENT  
TO THE SENATE AMENDMENT TO H.R. 4853,  
THE “MIDDLE CLASS TAX RELIEF ACT OF 2010,”  
SCHEDULED FOR CONSIDERATION BY THE U.S. HOUSE  
OF REPRESENTATIVES ON DECEMBER 2, 2010**

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of the  
JOINT COMMITTEE ON TAXATION



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## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a technical explanation of an amendment to the Senate Amendment to H.R. 4853, the “Middle Class Tax Relief Act of 2010.” Unless otherwise indicated, all section references are to the Internal Revenue Code of 1986, as amended.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Technical Explanation of An Amendment to the Senate Amendment to H.R. 4853, The “Middle Class Tax Relief Act Of 2010,” Scheduled For Consideration By The U.S. House of Representatives On December 2, 2010* (JCX-52-10), December 2, 2010. This document can also be found on our website at [www.jct.gov](http://www.jct.gov).

## I. MIDDLE CLASS TAX RELIEF MADE PERMANENT

### 1. Marginal individual income tax rate reductions (secs. 101 and 102(a) of the bill and sec. 1 of the Code)

#### Present Law

##### In general

The Economic Growth and Tax Relief Reconciliation Act of 2001<sup>2</sup> (“EGTRRA”) created a new 10-percent regular income tax bracket for a portion of taxable income that was previously taxed at 15 percent. EGTRRA also reduced the other regular income tax rates. The otherwise applicable regular income tax rates of 28 percent, 31 percent, 36 percent and 39.6 percent were reduced to 25 percent, 28 percent, 33 percent, and 35 percent, respectively. These provisions of EGTRRA shall cease to apply for taxable years beginning after December 31, 2010.

##### Tax rate schedules

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to his or her regular 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. Separate rate schedules apply based on an individual’s filing status. For 2010, the regular individual income tax rate schedules are as follows:

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<sup>2</sup> Pub. L. No. 107-16.

**Table 1.—Federal Individual Income Tax Rates for 2010**

If taxable income is:	Then income tax equals:
Single Individuals	
Not over \$8,375	10% of the taxable income
Over \$8,375 but not over \$34,000	\$837.50 plus 15% of the excess over \$8,375
Over \$34,000 but not over \$82,400	\$4,681.25 plus 25% of the excess over \$34,000
Over \$82,400 but not over \$171,850	\$16,781.25 plus 28% of the excess over \$82,400
Over \$171,850 but not over \$373,650	\$41,827.25 plus 33% of the excess over \$171,850
Over \$373,650	\$108,421.25 plus 35% of the excess over \$373,650
Heads of Households	
Not over \$11,950	10% of the taxable income
Over \$11,950 but not over \$45,550	\$1,195 plus 15% of the excess over \$11,950
Over \$45,550 but not over \$117,650	\$6,235 plus 25% of the excess over \$45,550
Over \$117,650 but not over \$190,550	\$24,260 plus 28% of the excess over \$117,650
Over \$190,550 but not over \$373,650	\$44,672 plus 33% of the excess over \$190,550
Over \$373,650	\$105,095 plus 35% of the excess over \$373,650
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over \$16,750	10% of the taxable income
Over \$16,750 but not over \$68,000	\$1,675 plus 15% of the excess over \$16,750
Over \$68,000 but not over \$137,300	\$9,362.50 plus 25% of the excess over \$68,000
Over \$137,300 but not over \$209,250	\$26,687.50 plus 28% of the excess over \$137,300
Over \$209,250 but not over \$373,650	\$46,833.50 plus 33% of the excess over \$209,250
Over \$373,650	\$101,085.50 plus 35% of the excess over \$373,650
Married Individuals Filing Separate Returns	
Not over \$8,375	10% of the taxable income
Over \$8,375 but not over \$34,000	\$837.50 plus 15% of the excess over \$8,375
Over \$34,000 but not over \$68,650	\$4,681.25 plus 25% of the excess over \$34,000
Over \$68,650 but not over \$104,625	\$13,343.75 plus 28% of the excess over \$68,650
Over \$104,625 but not over \$186,825	\$23,416.75 plus 33% of the excess over \$104,625
Over \$186,825	\$50,542.75 plus 35% of the excess over \$186,825

### **Explanation of Provision**

The provision permanently extends the 10-percent, 15-percent, 25-percent and 28-percent individual income tax rates. For taxable years beginning after December 31, 2010, the 33-percent rate bracket becomes the 33-percent (as described below) and 36-percent rate brackets and the 35-percent rate bracket becomes the 39.6-percent rate bracket.

For single individuals, the 33-percent rate remains in effect for taxable incomes of less than \$193,800 in 2011 (\$200,000 of adjusted gross income (“AGI”) indexed from 2009, less one personal exemption (\$3,700) and the basic standard deduction (\$5,800)).

For married individuals filing joint returns and surviving spouses, the 33-percent rate remains in effect for taxable incomes of less than \$235,150 in 2011 (\$250,000 of AGI indexed from 2009, less two personal exemptions (\$7,400) and the basic standard deduction (\$11,600)). For married individuals filing a separate return, the amount is one-half the amount applicable to joint returns.

For heads of household, the 33-percent rate bracket becomes the 36-percent rate bracket.

The rate structure is indexed for inflation.

A comparison of Table 2, below, with Table 1, above, illustrates the tax rate changes. Note that Table 2 also incorporates the provision to retain the marriage penalty relief with respect to the size of the 15 percent rate bracket, as discussed below.

**Table 2.—Federal Individual Income Tax Rates for 2011**

If taxable income is:	Then income tax equals:
Single Individuals	
Not over \$8,500	10% of the taxable income
Over \$8,500 but not over \$34,500	\$850 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$83,600	\$4,750 plus 25% of the excess over \$34,500
Over \$83,600 but not over \$174,400	\$17,025 plus 28% of the excess over \$83,600
Over \$174,400 but not over \$193,800	\$42,449 plus 33% of the excess over \$174,400
Over \$193,800 but not over \$379,150	\$48,851 plus 36% of the excess over \$193,800
Over \$379,150	\$115,577 plus 39.6% of the excess over \$379,150
Heads of Households	
Not over \$12,150	10% of the taxable income
Over \$12,150 but not over \$46,250	\$1,215 plus 15% of the excess over \$12,150
Over \$46,250 but not over \$119,400	\$6,330 plus 25% of the excess over \$46,250
Over \$119,400 but not over \$193,350	\$24,617.50 plus 28% of the excess over \$119,400
Over \$193,350 but not over \$379,150	\$45,323.50 plus 36% of the excess over \$193,350
Over \$379,150	\$112,211.50 plus 39.6% of the excess over \$379,150
Married Individuals Filing Joint Returns and Surviving Spouses	
Not over \$17,000	10% of the taxable income
Over \$17,000 but not over \$69,000	\$1,700 plus 15% of the excess over \$17,000
Over \$69,000 but not over \$139,350	\$9,500 plus 25% of the excess over \$69,000
Over \$139,350 but not over \$212,300	\$27,087.50 plus 28% of the excess over \$139,350
Over \$212,300 but not over \$235,150	\$47,513.50 plus 33% of the excess over \$212,350
Over \$235,150 but not over \$379,150	\$55,054 plus 36% of the excess over \$235,150
Over \$379,150	\$106,894 plus 39.6% of the excess over \$379,150
Married Individuals Filing Separate Returns	
Not over \$8,500	10% of the taxable income
Over \$8,500 but not over \$34,500	\$850 plus 15% of the excess over \$8,500
Over \$34,500 but not over \$69,675	\$4,750 plus 25% of the excess over \$34,500
Over \$69,675 but not over \$106,150	\$13,543.75 plus 28% of the excess over \$69,675
Over \$106,150 but not over \$117,575	\$23,756.75 plus 33% of the excess over \$106,150
Over \$117,575 but not over \$189,575	\$27,527 plus 36% of the excess over \$117,575
Over \$189,575	\$53,447 plus 39.6% of the excess over \$189,575

## Effective Date

The provision applies to taxable years beginning after December 31, 2010.

## **2. Child tax credit (secs. 101 and 103 of the bill and sec. 24 of the Code)**

### Present Law

An individual may claim a tax credit for each qualifying child under the age of 17. The maximum amount of the credit per child is \$1,000 through 2010 and \$500 thereafter. A child who is not a citizen, national, or resident of the United States cannot be a qualifying child.

The aggregate amount of child credits that may be claimed is phased out for individuals with income over certain threshold amounts. Specifically, the otherwise allowable aggregate child tax credit amount is reduced by \$50 for each \$1,000 (or fraction thereof) of modified adjusted gross income (“modified AGI”) over \$75,000 for single individuals or heads of households, \$110,000 for married individuals filing joint returns, and \$55,000 for married individuals filing separate returns. For purposes of this limitation, modified AGI includes certain otherwise excludable income earned by U.S. citizens or residents living abroad or in certain U.S. territories.

The credit is allowable against the regular tax and, for taxable years beginning before January 1, 2011, is allowed against the alternative minimum tax (“AMT”). To the extent the child tax credit exceeds the taxpayer’s tax liability, the taxpayer is eligible for a refundable credit (the additional child tax credit) equal to 15 percent of earned income in excess of a threshold dollar amount (the “earned income” formula). EGTRRA provided, in general, that this threshold dollar amount is \$10,000 indexed for inflation from 2001. The American Recovery and Reinvestment Act of 2009 set the threshold at \$3,000 for both 2009 and 2010. After 2010, the ability to determine the refundable child credit based on earned income in excess of the threshold dollar amount expires.

Families with three or more qualifying children may determine the additional child tax credit using the “alternative formula” if this results in a larger credit than determined under the earned income formula. Under the alternative formula, the additional child tax credit equals the amount by which the taxpayer’s social security taxes exceed the taxpayer’s earned income tax credit (“EITC”). After 2010, due to the expiration of the earned income formula, this is the only manner of obtaining a refundable child credit.

Earned income is defined as the sum of wages, salaries, tips, and other taxable employee compensation plus net self-employment earnings. Unlike the EITC, which also includes the preceding items in its definition of earned income, the additional child tax credit is based only on earned income to the extent it is included in computing taxable income. For example, some ministers’ parsonage allowances are considered self-employment income, and thus are considered earned income for purposes of computing the EITC, but the allowances are excluded from gross income for individual income tax purposes, and thus are not considered earned income for purposes of the additional child tax credit since the income is not included in taxable income.

### **Explanation of Provision**

The provision permanently extends the \$1,000 child tax credit and allows the child tax credit against the individual's regular income tax and AMT. The provision also permanently extends the EGTRRA repeal of a prior-law provision that reduced the refundable child credit by the amount of the AMT. The provision permanently extends the earned income formula for determining the refundable child credit, with the earned income threshold of \$3,000 (also, the provision stops indexation for inflation of the \$3,000 earnings threshold). Finally, the provision permanently extends the rule that the refundable portion of the child tax credit does not constitute income and shall not be treated as resources for purposes of determining eligibility or the amount or nature of benefits or assistance under any Federal program or any State or local program financed with Federal funds.

### **Effective Date**

The provision applies to taxable years beginning after December 31, 2010.

### **3. Marriage penalty relief and earned income tax credit simplification (secs. 101 and 103 of the bill and secs. 1, 32, and 63 of the Code)**

#### **Present Law**

##### **Marriage penalty**

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

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

##### **Basic standard deduction**

EGTRRA increased the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return. The basic standard deduction for a married taxpayer filing separately continued to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately are the same.

### **Fifteen percent rate bracket**

EGTRRA increased the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return.

### **Earned income tax credit**

The earned income tax credit (“EITC”) is a refundable tax credit available to certain lower-income individuals. Generally, the amount of an individual’s allowable earned income credit is dependent on the individual’s earned income, adjusted gross income, and the number of qualifying children.

### **Explanation of Provision**

#### **Basic standard deduction**

The provision permanently increases the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return.

#### **15 percent rate bracket**

The provision permanently increases the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the 15-percent regular income tax rate bracket for an unmarried individual filing a single return.

#### **Earned income tax credit**

The provision permanently extends certain EITC provisions adopted by EGTRRA. These include: (1) a simplified definition of earned income; (2) a simplified relationship test; (3) a simplified tie-breaking rule; (4) additional math error authority for the Internal Revenue Service; (5) a repeal of the prior-law provision that reduced an individual’s EITC by the amount of his alternative minimum tax liability; and (6) increases in the beginning and ending points of the credit phase-out for married taxpayers by \$5,000.<sup>3</sup>

### **Effective Date**

The provision applies to taxable years beginning after December 31, 2010.

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<sup>3</sup> The amount is indexed for inflation annually.

#### **4. Education incentives (sec. 101 of the bill and secs. 117, 127, 142, 146-148, 221, and 530 of the Code)**

##### **Present Law**

##### **Income and wage exclusion for awards under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program**

Section 117 excludes from gross income amounts received as a qualified scholarship by an individual who is a candidate for a degree and used for tuition and fees required for the enrollment or attendance (or for fees, books, supplies, and equipment required for courses of instruction) at a primary, secondary, or post-secondary educational institution. The tax-free treatment provided by section 117 does not extend to scholarship amounts covering regular living expenses, such as room and board. In addition to the exclusion for qualified scholarships, section 117 provides an exclusion from gross income for qualified tuition reductions for certain education provided to employees (and their spouses and dependents) of certain educational organizations. Amounts excludable from gross income under section 117 are also excludable from wages for payroll tax purposes.<sup>4</sup>

The exclusion for qualified scholarships and qualified tuition reductions does not apply to any amount received by a student that represents payment for teaching, research, or other services by the student required as a condition for receiving the scholarship or tuition reduction. An exception to this rule applies in the case of the National Health Service Corps Scholarship Program (the “NHSC Scholarship Program”) and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (the “Armed Forces Scholarship Program”).

The NHSC Scholarship Program and the Armed Forces Scholarship Program provide education awards to participants on the condition that the participants provide certain services. In the case of the NHSC Scholarship Program, the recipient of the scholarship is obligated to provide medical services in a geographic area (or to an underserved population group or designated facility) identified by the Public Health Service as having a shortage of health care professionals. In the case of the Armed Forces Scholarship Program, the recipient of the scholarship is obligated to serve a certain number of years in the military at an armed forces medical facility.

Under the sunset provisions of EGTRRA, the exclusion from gross income and wages for the NHSC Scholarship Program and the Armed Forces Scholarship Program will no longer apply for taxable years beginning after December 31, 2010.

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<sup>4</sup> Sec. 3121(a)(20).

## **Income and wage exclusion for employer-provided educational assistance**

If certain requirements are satisfied, up to \$5,250 annually of educational assistance provided by an employer to an employee is excludable from gross income for income tax purposes and from wages for employment tax purposes.<sup>5</sup> This exclusion applies to both graduate and undergraduate courses.<sup>6</sup> For the exclusion to apply, certain requirements must be satisfied. The educational assistance must be provided pursuant to a separate written plan of the employer. The employer's educational assistance program must not discriminate in favor of highly compensated employees. In addition, no more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance program can be provided for the class of individuals consisting of more than five-percent owners of the employer and the spouses or dependents of such more than five-percent owners.

For purposes of the exclusion, educational assistance means the payment by an employer of expenses incurred by or on behalf of the employee for education of the employee including, but not limited to, tuition, fees, and similar payments, books, supplies, and equipment. Educational assistance also includes the provision by the employer of courses of instruction for the employee (including books, supplies, and equipment). Educational assistance does not include (1) tools or supplies that may be retained by the employee after completion of a course, (2) meals, lodging, or transportation, or (3) any education involving sports, games, or hobbies. The exclusion for employer-provided educational assistance applies only with respect to education provided to the employee (e.g., it does not apply to education provided to the spouse or a child of the employee).

In the absence of the specific exclusion for employer-provided educational assistance under section 127, employer-provided educational assistance is excludable from gross income and wages only if the education expenses qualify as a working condition fringe benefit.<sup>7</sup> In general, education qualifies as a working condition fringe benefit if the employee could have deducted the education expenses under section 162 if the employee paid for the education. In general, education expenses are deductible by an individual under section 162 if the education (1) maintains or improves a skill required in a trade or business currently engaged in by the taxpayer, or (2) meets the express requirements of the taxpayer's employer, applicable law, or regulations imposed as a condition of continued employment. However, education expenses are generally not deductible if they relate to certain minimum educational requirements or to

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<sup>5</sup> Secs. 127, 3121(a)(18).

<sup>6</sup> The exclusion has not always applied to graduate courses. The exclusion was first made inapplicable to graduate-level courses by the Technical and Miscellaneous Revenue Act of 1988. The exclusion was reinstated with respect to graduate-level courses by the Omnibus Budget Reconciliation Act of 1990, effective for taxable years beginning after December 31, 1990. The exclusion was again made inapplicable to graduate-level courses by the Small Business Job Protection Act of 1996, effective for courses beginning after June 30, 1996. The exclusion for graduate-level courses was reinstated by EGTRRA, although that change does not apply to taxable years beginning after December 31, 2010 (under EGTRRA's sunset provision).

<sup>7</sup> Sec. 132(d).

education or training that enables a taxpayer to begin working in a new trade or business. In determining the amount deductible for this purpose, the two-percent floor on miscellaneous itemized deductions is disregarded.

The specific exclusion for employer-provided educational assistance was originally enacted on a temporary basis and was subsequently extended 10 times.<sup>8</sup> EGTRRA deleted the exclusion's explicit expiration date and extended the exclusion to graduate courses. However, those changes are subject to EGTRRA's sunset provision so that the exclusion will not be available for taxable years beginning after December 31, 2010. Thus, at that time, educational assistance will be excludable from gross income only if it qualifies as a working condition fringe benefit (i.e., the expenses would have been deductible as business expenses if paid by the employee). As previously discussed, to meet such requirement, the expenses must be related to the employee's current job.<sup>9</sup>

### **Deduction for student loan interest**

Certain individuals who have paid interest on qualified education loans may claim an above-the-line deduction for such interest expenses, subject to a maximum annual deduction limit.<sup>10</sup> Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

A qualified education loan generally is defined as any indebtedness incurred solely to pay for the costs of attendance (including room and board) of the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred in attending an eligible educational institution on at least a half-time basis. Eligible educational institutions are (1) post-secondary educational institutions and certain vocational schools defined by reference to section 481 of the Higher Education Act of 1965, or (2) institutions conducting internship or residency programs leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training. Additionally, to qualify as an eligible educational institution, an institution must be eligible to participate in Department of Education student aid programs.

The maximum allowable deduction per year is \$2,500. For 2010, the deduction is phased out ratably for single taxpayers with AGI between \$60,000 and \$75,000 and between \$120,000 and \$150,000 for married taxpayers filing a joint return. The income phaseout ranges are indexed for inflation and rounded to the next lowest multiple of \$5,000.

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<sup>8</sup> The exclusion was first enacted as part of the Revenue Act of 1978 (with a 1983 expiration date).

<sup>9</sup> Treas. Reg. sec. 1.162-5.

<sup>10</sup> Sec. 221.

Effective for taxable years beginning after December 31, 2010, the changes made by EGTRRA to the student loan provisions no longer apply. The EGTRRA changes scheduled to expire are: (1) increases that were made in the AGI phaseout ranges for the deduction and (2) rules that extended deductibility of interest beyond the first 60 months that interest payments are required. With the expiration of EGTRRA, the phaseout ranges will revert to a base level of \$40,000 to \$55,000 (\$60,000 to \$75,000 in the case of a married couple filing jointly), but with an adjustment for inflation occurring since 2002.

### **Coverdell education savings accounts**

A Coverdell education savings account is a trust or custodial account created exclusively for the purpose of paying qualified education expenses of a named beneficiary.<sup>11</sup> Annual contributions to Coverdell education savings accounts may not exceed \$2,000 per designated beneficiary and may not be made after the designated beneficiary reaches age 18 (except in the case of a special needs beneficiary). The contribution limit is phased out for taxpayers with modified AGI between \$95,000 and \$110,000 (\$190,000 and \$220,000 for married taxpayers filing a joint return); the AGI of the contributor, and not that of the beneficiary, controls whether a contribution is permitted by the taxpayer.

Earnings on contributions to a Coverdell education savings account generally are subject to tax when withdrawn.<sup>12</sup> However, distributions from a Coverdell education savings account are excludable from the gross income of the distributee (i.e., the student) to the extent that the distribution does not exceed the qualified education expenses incurred by the beneficiary during the year the distribution is made. The earnings portion of a Coverdell education savings account distribution not used to pay qualified education expenses is includible in the gross income of the distributee and generally is subject to an additional 10-percent tax.<sup>13</sup>

Tax-free (including free of additional 10-percent tax) transfers or rollovers of account balances from one Coverdell education savings account benefiting one beneficiary to another Coverdell education savings account benefiting another beneficiary (as well as redesignations of the named beneficiary) are permitted, provided that the new beneficiary is a member of the family of the prior beneficiary and is under age 30 (except in the case of a special needs beneficiary). In general, any balance remaining in a Coverdell education savings account is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if the beneficiary dies before attaining age 30, within 30 days of the date that the beneficiary dies).

Qualified education expenses include “qualified higher education expenses” and “qualified elementary and secondary education expenses.”

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<sup>11</sup> Sec. 530.

<sup>12</sup> In addition, Coverdell education savings accounts are subject to the unrelated business income tax imposed by section 511.

<sup>13</sup> This 10-percent additional tax does not apply if a distribution from an education savings account is made on account of the death or disability of the designated beneficiary, or if made on account of a scholarship received by the designated beneficiary.

The term “qualified higher education expenses” includes tuition, fees, books, supplies, and equipment required for the enrollment or attendance of the designated beneficiary at an eligible education institution, regardless of whether the beneficiary is enrolled at an eligible educational institution on a full-time, half-time, or less than half-time basis.<sup>14</sup> Moreover, qualified higher education expenses include certain room and board expenses for any period during which the beneficiary is at least a half-time student. Qualified higher education expenses include expenses with respect to undergraduate or graduate-level courses. In addition, qualified higher education expenses include amounts paid or incurred to purchase tuition credits (or to make contributions to an account) under a qualified tuition program for the benefit of the beneficiary of the Coverdell education savings account.<sup>15</sup>

The term “qualified elementary and secondary education expenses,” means expenses for: (1) tuition, fees, academic tutoring, special needs services, books, supplies, and other equipment incurred in connection with the enrollment or attendance of the beneficiary at a public, private, or religious school providing elementary or secondary education (kindergarten through grade 12) as determined under State law; (2) room and board, uniforms, transportation, and supplementary items or services (including extended day programs) required or provided by such a school in connection with such enrollment or attendance of the beneficiary; and (3) the purchase of any computer technology or equipment (as defined in section 170(e)(6)(F)(i)) or Internet access and related services, if such technology, equipment, or services are to be used by the beneficiary and the beneficiary’s family during any of the years the beneficiary is in elementary or secondary school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary education expense unless the software is predominantly educational in nature.

Qualified education expenses generally include only out-of-pocket expenses. Such qualified education expenses do not include expenses covered by employer-provided educational assistance or scholarships for the benefit of the beneficiary that are excludable from gross income. Thus, total qualified education expenses are reduced by scholarship or fellowship grants excludable from gross income under section 117, as well as any other tax-free educational benefits, such as employer-provided educational assistance, that are excludable from the employee’s gross income under section 127.

Effective for taxable years beginning after December 31, 2010, the changes made by EGTRRA to Coverdell education savings accounts no longer apply. The EGTRRA changes scheduled to expire are: (1) the increase in the contribution limit to \$2,000 from \$500; (2) the increase in the phaseout range for married taxpayers filing jointly to \$190,000-\$220,000 from \$150,000-\$160,000; (3) the expansion of qualified expenses to include elementary and secondary education expenses; (4) special age rules for special needs beneficiaries; (5) clarification that corporations and other entities are permitted to make contributions, regardless of the income of the corporation or entity during the year of the contribution; (6) certain rules regarding when

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<sup>14</sup> Qualified higher education expenses are defined in the same manner as for qualified tuition programs.

<sup>15</sup> Sec. 530(b)(2)(B).

contributions are deemed made and extending the time during which excess contributions may be returned without additional tax; (7) certain rules regarding coordination with the Hope and Lifetime Learning credits; and (8) certain rules regarding coordination with qualified tuition programs.

### **Amount of governmental bonds that may be issued by governments qualifying for the “small governmental unit” arbitrage rebate exception**

To prevent State and local governments from issuing more Federally subsidized tax-exempt bonds than is necessary for the activity being financed or from issuing such bonds earlier than needed for the purpose of the borrowing, the Code includes arbitrage restrictions limiting the ability to profit from investment of tax-exempt bond proceeds.<sup>16</sup> The Code also provides certain exceptions to the arbitrage restrictions. Under one such exception, small issuers of governmental bonds issued for local governmental activities are not subject to the rebate requirement.<sup>17</sup> To qualify for this exception the governmental bonds must be issued by a governmental unit with general taxing powers that reasonably expects to issue no more than \$5 million of tax-exempt governmental bonds in a calendar year.<sup>18</sup> Prior to EGTRRA, the \$5 million limit was increased to \$10 million if at least \$5 million of the bonds are used to finance public schools. EGTRRA provided the additional amount of governmental bonds for public schools that small governmental units may issue without being subject to the arbitrage rebate requirements is increased from \$5 million to \$10 million.<sup>19</sup> Thus, these governmental units may issue up to \$15 million of governmental bonds in a calendar year provided that at least \$10 million of the bonds are used to finance public school construction expenditures. This increase is subject to the EGTRRA sunset.

### **Issuance of tax-exempt private activity bonds for public school facilities**

Interest on bonds that nominally are issued by State or local governments, but the proceeds of which are used (directly or indirectly) by a private person and payment of which is derived from funds of such a private person is taxable unless the purpose of the borrowing is approved specifically in the Code or in a non-Code provision of a revenue act. These bonds are

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<sup>16</sup> The exclusion from gross income for interest on State and local bonds does not apply to any arbitrage bond (sec. 103(a), (b)(2)). A bond is an arbitrage bond if it is part of an issue that violates the restrictions against investing in higher-yielding investments under section 148(a) or that fails to satisfy the requirement to rebate arbitrage earnings under section 148(f).

<sup>17</sup> Ninety-five percent or more of the net proceeds of governmental bond issue are to be used for local governmental activities of the issuer. Sec. 148(f)(4)(D).

<sup>18</sup> Under the Treasury regulations, an issuer may apply a fact-based rather than an expectations-based test. Treas. Reg. 1.148-8(c)(1).

<sup>19</sup> Sec. 148(f)(4)(D)(vii).

called “private activity bonds.”<sup>20</sup> The term “private person” includes the Federal government and all other individuals and entities other than State or local governments.

Only specified private activity bonds are tax-exempt. EGTRRA added a new type of private activity bond that is subject to the EGTRRA sunset. This category is bonds for elementary and secondary public school facilities that are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency.<sup>21</sup> The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events) and depreciable personal property used in the school facility. The school facilities for which these bonds are issued must be operated by a public educational agency as part of a system of public schools.

A public-private partnership agreement is defined as an arrangement pursuant to which the for-profit corporate party constructs, rehabilitates, refurbishes, or equips a school facility for a public school agency (typically pursuant to a lease arrangement). The agreement must provide that, at the end of the contract term, ownership of the bond-financed property is transferred to the public school agency party to the agreement for no additional consideration.

Issuance of these bonds is subject to a separate annual per-State private activity bond volume limit equal to \$10 per resident (\$5 million, if greater) in lieu of the present-law State private activity bond volume limits. As with the present-law State private activity bond volume limits, States can decide how to allocate the bond authority to State and local government agencies. Bond authority that is unused in the year in which it arises may be carried forward for up to three years for public school projects under rules similar to the carryforward rules of the present-law private activity bond volume limits.

### **Explanation of Provision**

The provision repeals the EGTRRA sunset as it applies to the NHSC Scholarship Program and the Armed Forces Scholarship Program, the section 127 exclusion from income and wages for employer-provided educational assistance, the student loan interest deduction, and Coverdell education savings accounts. The provision also repeals the EGTRRA sunset as it applies to the expansion of the small government unit exception to arbitrage rebate and allowing issuance of tax-exempt private activity bonds for public school facilities. Thus, all of these tax benefits for education continue to be permanently available after 2010.

### **Effective Date**

The provision is effective on the date of enactment.

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<sup>20</sup> The Code provides that the exclusion from gross income does not apply to interest on private activity bonds that are not qualified bonds within the meaning of section 141. See secs. 103(b)(1), 141.

<sup>21</sup> Sec. 142(a)(13), (k).

**5. Other incentives for families and children (includes extension of the adoption tax credit, employer-provided child care tax credit, and dependent care tax credit) (sec. 101 of the bill and secs. 21, 23, 45D, and 137 of the Code)**

**Present Law**

**Adoption credit and exclusion from income for employer-provided adoption assistance**

Present law for 2010 provides: (1) a maximum adoption credit of \$13,170 per eligible child (both special needs and non-special needs adoptions); and (2) a maximum exclusion of \$13,170 per eligible child (both special needs and non-special needs adoptions). These dollar amounts are adjusted annually for inflation. These benefits are phased-out over a \$40,000 range for taxpayers with modified adjusted gross income (“modified AGI”) in excess of certain dollar levels. For 2010, the phase-out range is between \$182,520 and \$222,520. The phase-out threshold is adjusted for inflation annually, but the phase-out range remains a \$40,000 range.

For taxable years beginning after December 31, 2011, the adoption credit and employer-provided adoption assistance exclusion are available only to special needs adoptions and the maximum credit and exclusion are reduced to \$6,000, respectively. The phase-out range is reduced to lower income levels (i.e., between \$75,000 and \$115,000). The maximum credit, exclusion, and phase-out range are not indexed for inflation.

**Employer-provided child care tax credit**

Taxpayers receive a tax credit equal to 25 percent of qualified expenses for employee child care and 10 percent of qualified expenses for child care resource and referral services. The maximum total credit that may be claimed by a taxpayer cannot exceed \$150,000 per taxable year.

Qualified child care expenses include costs paid or incurred: (1) to acquire, construct, rehabilitate or expand property that is to be used as part of the taxpayer’s qualified child care facility; (2) for the operation of the taxpayer’s qualified child care facility, including the costs of training and certain compensation for employees of the child care facility, and scholarship programs; or (3) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer. To be a qualified child care facility, the principal use of the facility must be for child care (unless it is the principal residence of the taxpayer), and the facility must meet all applicable State and local laws and regulations, including any licensing laws. A facility is not treated as a qualified child care facility with respect to a taxpayer unless: (1) it has open enrollment to the employees of the taxpayer; (2) use of the facility (or eligibility to use such facility) does not discriminate in favor of highly compensated employees of the taxpayer (within the meaning of section 414(q) of the Code); and (3) at least 30 percent of the children enrolled in the center are dependents of the taxpayer’s employees, if the facility is the principal trade or business of the taxpayer. Qualified child care resource and referral expenses are amounts paid or incurred under a contract to provide child care resource and referral services to the employees of the taxpayer. Qualified child care services and qualified child care resource and referral expenditures must be provided (or be eligible for use) in a way that does not discriminate in

favor of highly compensated employees of the taxpayer (within the meaning of section 414(q) of the Code.

Any amounts for which the taxpayer may otherwise claim a tax deduction are reduced by the amount of these credits. Similarly, if the credits are taken for expenses of acquiring, constructing, rehabilitating, or expanding a facility, the taxpayer's basis in the facility is reduced by the amount of the credits.

Credits taken for the expenses of acquiring, constructing, rehabilitating, or expanding a qualified facility are subject to recapture for the first ten years after the qualified child care facility is placed in service. The amount of recapture is reduced as a percentage of the applicable credit over the 10-year recapture period. Recapture takes effect if the taxpayer either ceases operation of the qualified child care facility or transfers its interest in the qualified child care facility without securing an agreement to assume recapture liability for the transferee. The recapture tax is not treated as a tax for purposes of determining the amount of other credits or determining the amount of the alternative minimum tax. Other rules apply.

This tax credit expires for taxable years beginning after December 31, 2010.

### **Dependent care tax credit**

The maximum dependent care tax credit is \$1,050 (35 percent of up to \$3,000 of eligible expenses) if there is one qualifying individual, and \$2,100 (35 percent of up to \$6,000 of eligible expenses) if there are two or more qualifying individuals. The 35-percent credit rate is reduced, but not below 20 percent, by one percentage point for each \$2,000 (or fraction thereof) of adjusted gross income above ("AGI") \$15,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with AGI over \$43,000.

The level of this credit is reduced for taxable years beginning after December 31, 2010, under the EGTRRA sunset.

## **Explanation of Provisions**

### **Adoption credit and exclusion from income for employer-provided adoption assistance**

The provision permanently extends the EGTRRA expansion of these two tax benefits.<sup>22</sup>

### **Employer-provided child care tax credit**

The provision permanently extends this tax benefit.

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<sup>22</sup> The changes to the adoption credit for 2010 and 2011 (relating to the size of the credit and its refundability) enacted as part of the Patient Protection and Affordable Care Act (Pub. L. No. 111-148) are unaffected by the provision.

## **Expansion of dependent care tax credit**

The provision permanently extends the dependent care tax credit EGTRRA expansion.

### **Effective Date**

The provisions apply to taxable years beginning after December 31, 2010.

## **6. Reduced rate on dividends and capital gains (secs. 101 and 102(c) of the bill and sec. 1(h) of the Code)**

### **Present Law**

#### **Dividends**

##### **In general**

A dividend is the distribution of property made by a corporation to its shareholders out of its after-tax earnings and profits.

##### **Tax rates before 2011**

An individual's qualified dividend income is taxed at the same rates that apply to net capital gain. This treatment applies for purposes of both the regular tax and the alternative minimum tax. Thus, for taxable years beginning before 2011, an individual's qualified dividend income is taxed at rates of zero and 15 percent. The zero-percent rate applies to qualified dividend income which otherwise would be taxed at a 10- or 15-percent rate if the special rates did not apply.

Qualified dividend income generally includes dividends received from domestic corporations and qualified foreign corporations. The term "qualified foreign corporation" includes a foreign corporation that is eligible for the benefits of a comprehensive income tax treaty with the United States which the Treasury Department determines to be satisfactory and which includes an exchange of information program. In addition, a foreign corporation is treated as a qualified foreign corporation for any dividend paid by the corporation with respect to stock that is readily tradable on an established securities market in the United States.

If a shareholder does not hold a share of stock for more than 60 days during the 121-day period beginning 60 days before the ex-dividend date (as measured under section 246(c)), dividends received on the stock are not eligible for the reduced rates. Also, the reduced rates are not available for dividends to the extent that the taxpayer is obligated to make related payments with respect to positions in substantially similar or related property.

Dividends received from a corporation that is a passive foreign investment company (as defined in section 1297) in either the taxable year of the distribution, or the preceding taxable year, are not qualified dividends.

Special rules apply in determining a taxpayer's foreign tax credit limitation under section 904 in the case of qualified dividend income. For these purposes, rules similar to the rules of section 904(b)(2)(B) concerning adjustments to the foreign tax credit limitation to reflect any capital gain rate differential will apply to any qualified dividend income.

If a taxpayer receives an extraordinary dividend (within the meaning of section 1059(c)) eligible for the reduced rates with respect to any share of stock, any loss on the sale of the stock is treated as a long-term capital loss to the extent of the dividend.

A dividend is treated as investment income for purposes of determining the amount of deductible investment interest only if the taxpayer elects to treat the dividend as not eligible for the reduced rates.

The amount of dividends qualifying for reduced rates that may be paid by a regulated investment company ("RIC") for any taxable year in which the qualified dividend income received by the RIC is less than 95 percent of its gross income (as specially computed) may not exceed the sum of (1) the qualified dividend income of the RIC for the taxable year and (2) the amount of earnings and profits accumulated in a non-RIC taxable year that were distributed by the RIC during the taxable year.

The amount of dividends qualifying for reduced rates that may be paid by a real estate investment trust ("REIT") for any taxable year may not exceed the sum of (1) the qualified dividend income of the REIT for the taxable year, (2) an amount equal to the excess of the income subject to the taxes imposed by section 857(b)(1) and the regulations prescribed under section 337(d) for the preceding taxable year over the amount of these taxes for the preceding taxable year, and (3) the amount of earnings and profits accumulated in a non-REIT taxable year that were distributed by the REIT during the taxable year.

The reduced rates do not apply to dividends received from an organization that was exempt from tax under section 501 or was a tax-exempt farmers' cooperative in either the taxable year of the distribution or the preceding taxable year; dividends received from a mutual savings bank that received a deduction under section 591; or deductible dividends paid on employer securities.<sup>23</sup>

### Tax rates after 2010

For taxable years beginning after 2010, dividends received by an individual are taxed at ordinary income tax rates.

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<sup>23</sup> In addition, for taxable years beginning before 2011, amounts treated as ordinary income on the disposition of certain preferred stock (sec. 306) are treated as dividends for purposes of applying the reduced rates; the tax rate for the accumulated earnings tax (sec. 531) and the personal holding company tax (sec. 541) is reduced to 15 percent; and the collapsible corporation rules (sec. 341) are repealed.

## Capital gains

### In general

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 a capital asset, any gain generally is included in income. Any net capital gain of an individual generally is taxed at rates lower than 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, (5) certain U.S. publications, (6) certain commodity derivative financial instruments, (7) hedging transactions, and (8) business supplies. 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 available under the straight-line method of depreciation.

### Tax rates before 2011

Under present law, for taxable years beginning before January 1, 2011, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. Any adjusted net capital gain which otherwise would be taxed at a 10- or 15-percent rate is taxed at a zero rate. These rates apply for purposes of both the regular tax and the AMT.

Under present law, 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 that 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 excess of the sum of 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) and the amount of gain equal to the additional amount of gain that would be excluded from gross income under section 1202 (relating to certain small business stock) if the percentage limitations of section 1202(a) did not apply, over the sum of 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, 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 (relating to certain property used in a trade or business) applies may not exceed the net section 1231 gain for the year.

An individual’s 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 10- or 15-percent rate is taxed at the otherwise applicable rate.

#### Tax rates after 2010

For taxable years beginning after December 31, 2010, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent. Any adjusted net capital gain which otherwise would be taxed at the 15-percent rate is taxed at a 10-percent rate.

In addition, any gain from the sale or exchange of property held more than five years that would otherwise have been taxed at the 10-percent capital gain rate is 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 began after December 31, 2000, that would otherwise have been taxed at a 20-percent rate is taxed at an 18-percent rate.

The tax rates on 28-percent gain and unrecaptured section 1250 gain are the same as for taxable years beginning before 2011.

#### **Explanation of Provision**

Under the provision, the tax rates for qualified dividend income and capital gain in effect before 2011 are made permanent with modifications for taxpayers with taxable income above the dollar amount at which the 36-percent bracket begins. A 20-percent rate is provided for the portion of the adjusted net capital gain which would (but for the special capital gain rates) be taxed at rates of 36 percent or above. The amount of qualified dividend income eligible for the lower capital gain rates is limited to the portion of the qualified dividend income which does not exceed an amount equal to the excess of the dollar amount at which the 36-percent rate begins over taxable income other than qualified dividend income; the remaining qualified dividend income is taxed at regular tax rates.

Similar tax rates apply for purposes of the alternative minimum tax.

Conforming amendments are made, including an amendment restoring the tax rates for the accumulated earnings tax and the personal holding company tax to the highest individual tax rate (39.6 percent under the bill).

### **Effective Date**

The provision applies to taxable years beginning after December 31, 2010.

### **7. The overall limitation on itemized deductions and the personal exemption phase-out (sec. 102 of the bill and secs. 68 and 151 of the Code)**

#### **Present Law**

#### **Overall limitation on itemized deductions (“Pease” limitation)**

Unless an individual elects to claim the standard deduction for a taxable year, the taxpayer is allowed to deduct his or her itemized deductions. Itemized deductions generally are those deductions which are not allowed in computing adjusted gross income (“AGI”). Itemized deductions include unreimbursed medical expenses, investment interest, casualty and theft losses, wagering losses, charitable contributions, qualified residence interest, State and local income and property taxes, unreimbursed employee business expenses, and certain other miscellaneous expenses.

Prior to 2010, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) was limited for upper-income taxpayers. In computing this reduction of total itemized deductions, all limitations applicable to such deductions (such as the separate floors) were first applied and, then, the otherwise allowable total amount of itemized deductions was reduced by three percent of the amount by which the taxpayer’s AGI exceeded a threshold amount which was indexed annually for inflation. The otherwise allowable itemized deductions could not be reduced by more than 80 percent.

EGTRRA repealed this overall limitation on itemized deductions with the repeal phased-in over five years. EGTRRA provided: (1) a one-third reduction of the otherwise applicable limitation in 2006 and 2007; (2) a two-thirds reduction in 2008, and 2009; and (3) no overall limitation on itemized deductions in 2010. Thus in 2009, for example, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) was reduced by three percent of the amount of the taxpayer’s AGI in excess of \$166,800 (\$83,400 for married couples filing separate returns). Then the overall reduction in itemized deductions was phased-down to 1/3 of the full reduction amount (that is, the limitation was reduced by two-thirds).

Pursuant to the general EGTRRA sunset, the phased-in repeal of the Pease limitation sunsets and the limitation becomes fully effective again in 2011. Adjusting for inflation, the AGI threshold is \$169,550 for 2011.

#### **Personal exemption phase-out for certain taxpayers (“PEP”)**

Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2010, the amount deductible for each personal exemption is \$3,650. This amount is indexed annually for inflation.

Prior to 2010, the deduction for personal exemptions was reduced or eliminated for taxpayers with incomes over certain thresholds, which were indexed annually for inflation. Specifically, the total amount of exemptions that could be claimed by a taxpayer was reduced by two percent for each \$2,500 (or portion thereof) by which the taxpayer's AGI exceeded the applicable threshold. (The phase-out rate was two percent for each \$1,250 for married taxpayers filing separate returns.) Thus, the personal exemptions claimed was phased-out over a \$122,500 range (which was not indexed for inflation), beginning at the applicable threshold.

In 2009, for example, the applicable thresholds were \$166,800 for single individuals, \$250,200 for married individuals filing a joint return and surviving spouses, \$199,950 for heads of households, and \$125,100 for married individuals filing separate returns.

EGTRRA repealed PEP with the repeal phased-in over five years. EGTRRA provided: (1) a one-third reduction of the otherwise applicable limitation in 2006 and 2007; (2) a two-thirds reduction in 2008, and 2009; and (3) no PEP in 2010. However, under the EGTRRA sunset, the PEP becomes fully effective again in 2011. Adjusted for inflation, the PEP thresholds for 2011 are: (1) \$169,550 for unmarried individuals; (2) \$254,350 for married couples filing joint returns; and (3) \$211,950 for heads of households.

### **Explanation of Provision**

#### **Overall limitation on itemized deductions ("Pease" limitation)**

The provision modifies the overall limitation on itemized deductions. The overall limitation on itemized deductions applies with a new AGI threshold beginning in 2011. The AGI threshold is \$250,000 for joint returns and surviving spouses, \$125,000 for married individuals filing separate returns, and \$200,000 for other individuals. These amounts are indexed for inflation from 2009. For 2011, these amounts are \$254,150, \$127,075, and \$203,300, respectively.

#### **Personal exemption phase-out for certain taxpayers ("PEP")**

The provision modifies the personal exemption phase-out. The personal exemption phase-out applies with a new AGI threshold beginning in 2011. The thresholds are the same amounts as for the "Pease" limitation described above.

### **Effective Date**

The provision applies to taxable years beginning after December 31, 2010.

## II. EXPENSING BY SMALL BUSINESSES OF CERTAIN DEPRECIABLE ASSETS

### A. Extend Temporary Increase in Expensing for Small Business (sec. 201 of the bill and sec. 179 of the Code)

#### Present Law

Subject to certain limitations, a taxpayer that invests in certain qualifying property may elect under section 179 to deduct (or “expense”) the cost of qualifying property, rather than to recover such costs through depreciation deductions.<sup>24</sup> For taxable years beginning in 2010 and 2011, the maximum amount that a taxpayer may expense is \$500,000 of the cost of qualifying property placed in service for the taxable year.<sup>25</sup> The \$500,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$2,000,000.<sup>26</sup> Off-the-shelf computer software placed in service in taxable years beginning before 2012 is treated as qualifying property.

The amount eligible to be expensed for a taxable year may not exceed the taxable income for a taxable year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation generally may be carried forward to succeeding taxable years (subject to similar limitations).<sup>27</sup> No general business credit under section 38 is allowed with respect to any amount for which a deduction is allowed under section 179. An expensing election is made under rules prescribed by the Secretary.<sup>28</sup>

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<sup>24</sup> Additional section 179 incentives are provided with respect to qualified property meeting applicable requirements that is used by a business in an empowerment zone (sec. 1397A), a renewal community (sec. 1400J), or the Gulf Opportunity Zone (sec. 1400N(e)). In addition, section 179(e) provides for an enhanced section 179 deduction for qualified disaster assistance property.

<sup>25</sup> The definition of qualifying property was temporarily (for 2010 and 2011) expanded to include up to \$250,000 of qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. See section 179(f)(2).

<sup>26</sup> The temporary \$500,000 and \$2,000,000 amounts were enacted in the Small Business Jobs Act of 2010, Pub. L. No. 111-240. The temporary \$250,000 and \$800,000 amounts were enacted in the Economic Stimulus Act of 2008, Pub. L. No. 110-185, extended for taxable years beginning in 2009 by the American Recovery and Reinvestment Act of 2009, Pub. L. No. 111-5, and extended for taxable years beginning in 2010 by the Hiring Incentives to Restore Employment Act of 2010, Pub. L. No. 111-147 (the “HIRE Act of 2010”).

<sup>27</sup> Special rules apply to limit the carryover of unused section 179 deductions attributable to qualified leasehold improvement property, qualified restaurant property, and qualified retail improvement property. See section 179(f)(4).

<sup>28</sup> Sec. 179(c)(1). Under Treas. Reg. sec. 1.179-5, applicable to property placed in service in taxable years beginning after 2002 and before 2008, a taxpayer is permitted to make or revoke an election under section 179 without the consent of the Commissioner on an amended Federal tax return for that taxable year. This amended return must be filed within the time prescribed by law for filing an amended return for the taxable year. T.D. 9209, July 12, 2005.

For taxable years beginning in 2012 and thereafter, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$25,000 of the cost of qualifying property placed in service for the taxable year. The \$25,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. The \$25,000 and \$200,000 amounts are not indexed. In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business (not including off-the-shelf computer software).

### **Explanation of Provision**<sup>29</sup>

The provision permanently increases the amount a taxpayer may deduct under section 179.<sup>30</sup> The bill provides that the maximum amount a taxpayer may expense, for taxable years beginning after 2011, is \$125,000 of the cost of qualifying property placed in service for the taxable year. The \$125,000 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$500,000. The \$125,000 and \$500,000 amounts are indexed for inflation.

In addition, the provision makes permanent the treatment of off-the-shelf computer software as qualifying property, as well as the provision permitting a taxpayer to amend or irrevocably revoke an election for a taxable year under section 179 without the consent of the Commissioner.

### **Effective Date**

The provision is effective for taxable years beginning after December 31, 2011.

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<sup>29</sup> The provision includes a provision to extend the rules under section 179 in place for taxable years beginning in 2008 and 2009 to taxable years beginning in 2010. This extension was enacted as part of the HIRE Act of 2010, as noted above.

<sup>30</sup> This permanent increase is with reference to the rules that would, absent the provision, apply to taxable years beginning after 2012.

### **III. EXTENSION OF ALTERNATIVE MINIMUM TAX RELIEF**

#### **A. Extension of Alternative Minimum Tax Relief for Nonrefundable Personal Credits and Increased Alternative Minimum Tax Exemption Amount (secs. 301 and 302 of the bill and secs. 26 and 55 of the Code)**

##### **Present Law**

Present law imposes an alternative minimum tax (“AMT”) on individuals. The AMT is the amount by which the tentative minimum tax exceeds the regular income tax. An individual’s tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not exceed \$175,000 (\$87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income (“AMTI”) as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are used in computing the tentative minimum tax. AMTI is the individual’s taxable income adjusted to take account of specified preferences and adjustments.

The exemption amounts are: (1) \$70,950 for taxable years beginning in 2009 and \$45,000 in taxable years beginning after 2009 in the case of married individuals filing a joint return and surviving spouses; (2) \$46,700 for taxable years beginning in 2009 and \$33,750 in taxable years beginning after 2009 in the case of other unmarried individuals; (3) \$35,475 for taxable years beginning in 2009 and \$22,500 in taxable years beginning after 2009 in the case of married individuals filing separate returns; and (4) \$22,500 in the case of an estate or trust. The exemption amount is phased out by an amount equal to 25 percent of the amount by which the individual’s AMTI exceeds (1) \$150,000 in the case of married individuals filing a joint return and surviving spouses, (2) \$112,500 in the case of other unmarried individuals, and (3) \$75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Present law provides for certain nonrefundable personal tax credits (i.e., the dependent care credit, the credit for the elderly and disabled, the child credit, the credit for interest on certain home mortgages, the Hope Scholarship and Lifetime Learning credits, the credit for savers, the credit for certain nonbusiness energy property, the credit for residential energy efficient property, the credit for certain plug-in electric vehicles, the credit for alternative motor vehicles, the credit for new qualified plug-in electric drive motor vehicles, and the D.C. first-time homebuyer credit).

For taxable years beginning before 2010, the nonrefundable personal credits are allowed to the extent of the full amount of the individual’s regular tax and alternative minimum tax.

For taxable years beginning after 2009, the nonrefundable personal credits (other than the child credit, the credit for savers, the credit for residential energy efficient property, the credit for certain plug-in electric drive motor vehicles, the credit for alternative motor vehicles, and credit for new qualified plug-in electric drive motor vehicles) are allowed only to the extent that the individual’s regular income tax liability exceeds the individual’s tentative minimum tax, determined without regard to the minimum tax foreign tax credit. The remaining nonrefundable

personal credits are allowed to the full extent of the individual's regular tax and alternative minimum tax.<sup>31</sup>

### **Explanation of Provisions**

The provision allows an individual to offset the entire regular tax liability and alternative minimum tax liability by the nonrefundable personal credits for 2010 and 2011.

The provision provides that the individual AMT exemption amount for taxable years beginning in 2010 and 2011 is \$72,450, in the case of married individuals filing a joint return and surviving spouses; (2) \$47,450 in the case of other unmarried individuals; and (3) \$36,225 in the case of married individuals filing separate returns.

### **Effective Date**

The provision is effective for taxable years beginning after 2009.

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<sup>31</sup> The rule applicable to the child credit after 2010 is subject to the EGTRRA sunset. The adoption credit is refundable in 2010 and 2011 and beginning in 2012 is nonrefundable and treated for purposes of the AMT in the same manner as the child credit.

#### **IV. BUDGETARY PROVISION**

##### **A. PAYGO Compliance (sec. 401 of the bill)**

##### **Explanation of Provision**

The budgetary effects of this bill, for purposes of complying with Statutory Pay-As-You-Go-Act of 2010, shall be determined by reference to the latest statement titled “Budgetary Effects of PAYGO Legislation” for this bill, submitted for printing in the Congressional Record by the Chairman of the House Budget Committee, provided that such statement has been submitted prior to vote on passage.