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REPORT
107–84

ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

CONFERENCE REPORT

TO ACCOMPANY

H.R. 1836

MAY 26 (legislative day, May 25), 2001.—Ordered to be printed

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Mr. THOMAS, from the committee of conference, submitted the following

CONFERENCE REPORT

[To accompany H.R. 1836]

The committee of conference on the disagreeing votes of he two Houses on the amendment of the Senate to the bill (H.R. 1836), to provide for reconciliation pursuant to section 104 of the concurrent resolution on the budget for fiscal year 2002, having met, after full and free conference, have agreed to recommend and do recommend to their respective Houses as follows:

That the House recede from its disagreement to the amendment of the Senate and agree to the same with an amendment as follows:

In lieu of the matter proposed to be inserted by the State amendment, insert the following:

SECTION 1. SHORT TITLE; REFERENCES; TABLE OF CONTENTS.

(a) SHORT TITLE.—This Act may be cited as the "Economic Growth and Tax Relief Reconciliation Act of 2001".

(b) AMENDMENT OF 1986 CODE.—Except as otherwise expressly provided, whenever in this Act an amendment or repeal is expressed in terms of an amendment to, or repeal of, a section or other provision, the reference shall be considered to be made to a section or other provision of the Internal Revenue Code of 1986.

(c) TABLE OF CONTENTS.—The table of contents of this Act is as follows:

Sec. 1. Short title; references; table of contents.

TITLE I—INDIVIDUAL INCOME TAX RATE REDUCTIONS

Sec. 101. Reduction in income tax rates for individuals.
Sec. 102. Repeal of phaseout of personal exemptions.
Sec. 103. Phaseout of overall limitation on itemized deductions.

TITLE II—TAX BENEFITS RELATING TO CHILDREN

Sec. 201. Modifications to child tax credit.
Sec. 202. Expansion of adoption credit and adoption assistance programs.

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Sec. 203. Refunds disregarded in the administration of Federal programs and federally assisted programs.
Sec. 204. Dependent care credit.
Sec. 205. Allowance of credit for employer expenses for child care assistance.

TITLE III—MARRIAGE PENALTY RELIEF

Sec. 301. Elimination of marriage penalty in standard deduction.
Sec. 302. Phaseout of marriage penalty in 15-percent bracket.
Sec. 303. Marriage penalty relief for earned income credit; earned income to include only amounts includible in gross income; simplification of earned income credit.

TITLE IV—AFFORDABLE EDUCATION PROVISIONS

Subtitle A—Education Savings Incentives

Sec. 401. Modifications to education individual retirement accounts.
Sec. 402. Modifications to qualified tuition programs.

Subtitle B—Educational Assistance

Sec. 411. Extension of exclusion for employer-provided educational assistance.
Sec. 412. Elimination of 60-month limit and increase in income limitation on student loan interest deduction.
Sec. 413. Exclusion of certain amounts received under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program.

Subtitle C—Liberalization of Tax-Exempt Financing Rules for Public School Construction

Sec. 421. Additional increase in arbitrage rebate exception for governmental bonds used to finance educational facilities.
Sec. 422. Treatment of qualified public educational facility bonds as exempt facility bonds.

Subtitle D—Other Provisions

Sec. 431. Deduction for higher education expenses.

TITLE V—ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS

Subtitle A—Repeal of Estate and Generation-Skipping Transfer Taxes

Sec. 501. Repeal of estate and generation-skipping transfer taxes.

Subtitle B—Reductions of Estate and Gift Tax Rates

Sec. 511. Additional reductions of estate and gift tax rates.

Subtitle C—Increase in Exemption Amounts

Sec. 521. Increase in exemption equivalent of unified credit, lifetime gifts exemption, and GST exemption amounts.

Subtitle D—Credit for State Death Taxes

Sec. 531. Reduction of credit for State death taxes.
Sec. 532. Credit for State death taxes replaced with deduction for such taxes.

Subtitle E—Carryover Basis at Death; Other Changes Taking Effect With Repeal

Sec. 541. Termination of step-up in basis at death.
Sec. 542. Treatment of property acquired from a decedent dying after December 31, 2009.

Subtitle F—Conservation Easements

Sec. 551. Expansion of estate tax rule for conservation easements.

Subtitle G—Modifications of Generation-Skipping Transfer Tax

Sec. 561. Deemed allocation of GST exemption to lifetime transfers to trusts; retroactive allocations.
Sec. 562. Severing of trusts.
Sec. 563. Modification of certain valuation rules.
Sec. 564. Relief provisions.

Subtitle H—Extension of Time for Payment of Estate Tax

Sec. 571. Increase in number of allowable partners and shareholders in closely held businesses.
Sec. 572. Expansion of availability of installment payment for estates with interests qualifying lending and finance businesses.
Sec. 572. Clarification of availability of installment payment.

Subtitle I—Other Provisions

Sec. 581. Waiver of statute of limitation for taxes on certain farm valuations.

TITLE VI—PENSION AND INDIVIDUAL RETIREMENT ARRANGEMENT PROVISIONS

Subtitle A—Individual Retirement Accounts

Sec. 601. Modification of IRA contribution limits.
Sec. 602. Deemed IRAs under employer plans.

Subtitle B—Expanding Coverage

Sec. 611. Increase in benefit and contribution limits.
Sec. 612. Plan loans for subchapter S owners, partners, and sole proprietors.
Sec. 613. Modification of top-heavy rules.
Sec. 614. Elective deferrals not taken into account for purposes of deduction limits.
Sec. 615. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations.
Sec. 616. Deduction limits.
Sec. 617. Option to treat elective deferrals as after-tax Roth contributions.
Sec. 618. Nonrefundable credit to certain individuals for elective deferrals and IRA contributions.
Sec. 619. Credit for pension plan startup costs of small employers.
Sec. 620. Elimination of user fee for requests to IRS regarding pension plans.
Sec. 621. Treatment of nonresident aliens engaged in international transportation services.

Subtitle C—Enhancing Fairness for Women

Sec. 631. Catch-up contributions for individuals age 50 or over.
Sec. 632. Equitable treatment for contributions of employees to defined contribution plans.
Sec. 633. Faster vesting of certain employer matching contributions.
Sec. 634. Modification to minimum distribution rules.
Sec. 635. Clarification of tax treatment of division of section 457 plan benefits upon divorce.
Sec. 636. Provisions relating to hardship distributions.
Sec. 637. Waiver of tax on nondeductible contributions for domestic or similar workers.

Subtitle D—Increasing Portability for Participants

Sec. 641. Rollovers allowed among various types of plans.
Sec. 642. Rollovers of IRAs into workplace retirement plans.
Sec. 643. Rollovers of after-tax contributions.
Sec. 644. Hardship exception to 60-day rule.
Sec. 645. Treatment of forms of distribution.
Sec. 646. Rationalization of restrictions on distributions.
Sec. 647. Purchase of service credit in governmental defined benefit plans.
Sec. 648. Employers may disregard rollovers for purposes of cash-out amounts.
Sec. 649. Minimum distribution and inclusion requirements for section 457 plans.

Subtitle E—Strengthening Pension Security and Enforcement

PART I—GENERAL PROVISIONS

Sec. 651. Repeal of 160 percent of current liability funding limit.
Sec. 652. Maximum contribution deduction rules modified and applied to all defined benefit plans.
Sec. 653. Excise tax relief for sound pension funding.
Sec. 654. Treatment of multiemployer plans under section 415.
Sec. 655. Protection of investment of employee contributions to 401(k) plans.
Sec. 656. Prohibited allocations of stock in S corporation ESOP.
Sec. 657. Automatic rollovers of certain mandatory distributions.
Sec. 658. Clarification of treatment of contributions to multiemployer plan.

PART II—TREATMENT OF PLAN AMENDMENTS REDUCING FUTURE BENEFIT ACCRUALS

Sec. 659. Excise tax on failure to provide notice by defined benefit plans significantly reducing future benefit accruals.

Subtitle F—Reducing Regulatory Burdens

Sec. 661. Modification of timing of plan valuations.
Sec. 662. ESOP dividends may be reinvested without loss of dividend deduction.
Sec. 663. Repeal of transition rule relating to certain highly compensated employees.
Sec. 664. Employees of tax-exempt entities.
Sec. 665. Clarification of treatment of employer-provided retirement advice.
Sec. 666. Repeal of the multiple use test.

Subtitle G—Miscellaneous Provisions

Sec. 671. Tax treatment and information requirements of Alaska Native Settlement Trusts.

TITLE VII—ALTERNATIVE MINIMUM TAX

Sec. 701. Increase in alternative minimum tax exemption.

TITLE VIII—OTHER PROVISIONS

Sec. 801. Time for payment of corporate estimated taxes.
Sec. 802. Expansion of authority to postpone certain tax-related deadlines by reason of Presidentially declared disaster.
Sec. 803. No Federal income tax on restitution received by victims of the Nazi regime or their heirs or estates.

TITLE IX—COMPLIANCE WITH CONGRESSIONAL BUDGET ACT

Sec. 901. Sunset of provisions of Act.

TITLE I—INDIVIDUAL INCOME TAX RATE REDUCTIONS

SEC. 101. REDUCTION IN INCOME TAX RATES FOR INDIVIDUALS.

(a) IN GENERAL.—Section 1 (relating to tax imposed) is amended by adding at the end the following new subsection:

"(i) RATE REDUCTIONS AFTER 2000.—

"(1) 10-PERCENT RATE BRACKET.—

"(A) IN GENERAL.—In the case of taxable years beginning after December 31, 2000—

"(i) the rate of tax under subsections (a), (b), (c), and (d) on taxable income not over the initial bracket amount shall be 10 percent, and

"(ii) the 15 percent rate of tax shall apply only to taxable income over the initial bracket amount but not over the maximum dollar amount for the 15-percent rate bracket.

"(B) INITIAL BRACKET AMOUNT.—For purposes of this paragraph, the initial bracket amount is—

"(i) $14,000 ($12,000 in the case of taxable years beginning before January 1, 2008) in the case of subsection (a),

"(ii) $10,000 in the case of subsection (b), and

"(iii) ½ the amount applicable under clause (i) (after adjustment, if any, under subparagraph (C)) in the case of subsections (c) and (d).

"(C) INFLATION ADJUSTMENT.—In prescribing the tables under subsection (f) which apply with respect to taxable years beginning in calendar years after 2000—

"(i) the Secretary shall make no adjustment to the initial bracket amount for any taxable year beginning before January 1, 2009,

"(ii) the cost-of-living adjustment used in making adjustments to the initial bracket amount for any taxable year beginning after December 31, 2008, shall be determined under subsection (f)(3) by substituting '2007' for '1992' in subparagraph (B) thereof, and

"(iii) such adjustment shall not apply to the amount referred to in subparagraph (B)(iii).

If any amount after adjustment under the preceding sentence is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.

"(D) COORDINATION WITH ACCELERATION OF 10 PERCENT RATE BRACKET BENEFIT FOR 2001.—This paragraph shall not apply to any taxable year to which section 6428 applies.

"(2) REDUCTIONS IN RATES AFTER JUNE 30, 2001.—In the case of taxable years beginning in a calendar year after 2000, the corresponding percentage specified for such calendar year in the following table shall be substituted for the otherwise applicable tax rate in the tables under subsections (a), (b), (c), (d), and (e).

"In the case of taxable years beginning during calendar year:	***The corresponding percentages shall be substituted for the following percentages:***			
	28%	***31%***	***36%***	***39.6%***
2001	*27.5%*	*30.5%*	*35.5%*	*39.1%*
2002 and 2003	*27.0%*	*30.0%*	*35.0%*	*38.6%*
2004 and 2005	*26.0%*	*29.0%*	*34.0%*	*37.6%*
2006 and thereafter	*25.0%*	*28.0%*	*33.0%*	*35.0%*

"(3) ADJUSTMENT OF TABLES.—The Secretary shall adjust the tables prescribed under subsection (f) to carry out this subsection.".

(b) ACCELERATION OF 10 PERCENT RATE BRACKET BENEFIT FOR 2001.—

(1) IN GENERAL.—Subchapter B of chapter 65 (relating to abatements, credits, and refunds) is amended by adding at the end the following new section:

"SEC. 6428. ACCELERATION OF 10 PERCENT INCOME TAX RATE BRACKET BENEFIT FOR 2001.

"(a) IN GENERAL.—In the case of an eligible individual, there shall be allowed as a credit against the tax imposed by chapter 1 for the taxpayer's first taxable year beginning in 2001 an amount equal to 5 percent of so much of the taxpayer's taxable income as does not exceed the initial bracket amount (as defined in section 1(i)(1)(B)).

"(b) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed by subsection (a) shall not exceed the excess (if any) of—

"(1) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

"(2) the sum of the credits allowable under part IV of subchapter A of chapter 1 (other than the credits allowable under subpart C thereof, relating to refundable credits).

"(c) ELIGIBLE INDIVIDUAL.—For purposes of this section, the term 'eligible individual' means any individual other than—

"(1) any estate or trust,

"(2) any nonresident alien individual, and

"(3) any individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which the individual's taxable year begins.

"(d) SPECIAL RULES.—

"(1) COORDINATION WITH ADVANCE REFUNDS OF CREDIT.—

"(A) IN GENERAL.—The amount of credit which would (but for this paragraph) be allowable under this section shall be reduced (but not below zero) by the aggregate refunds and credits made or allowed to the taxpayer under subsection (e). Any failure to so reduce the credit shall be treated as arising out of a mathematical or clerical error and assessed according to section 6213(b)(1).

"(B) JOINT RETURNS.—In the case of a refund or credit made or allowed under subsection (e) with respect to a joint return, half of such refund or credit shall be treated as having been made or allowed to each individual filing such return.

"(2) COORDINATION WITH ESTIMATED TAX.—The credit under this section shall be treated for purposes of section 6654(f) in the same manner as a credit under subpart A of part IV of subchapter A of chapter 1.

"(e) ADVANCE REFUNDS OF CREDIT BASED ON PRIOR YEAR DATA.—

"(1) IN GENERAL.—Each individual who was an eligible individual for such individual's first taxable year beginning in 2000 shall be treated as having made a payment against the tax imposed by chapter 1 for such first taxable year in an amount equal to the advance refund amount for such taxable year.

"(2) ADVANCE REFUND AMOUNT.—For purposes of paragraph (1), the advance refund amount is the amount that would have been allowed as a credit under this section for such first taxable year if this section (other than subsection (d) and this subsection) had applied to such taxable year.

"(3) TIMING OF PAYMENTS.—In the case of any overpayment attributable to this subsection, the Secretary shall, subject to the provisions of this title, refund or credit such overpayment as rapidly as possible and, to the extent practicable, before October 1, 2001. No refund or credit shall be made or allowed under this subsection after December 31, 2001.

"(4) NO INTEREST.—No interest shall be allowed on any overpayment attributable to this subsection.".

(2) CLERICAL AMENDMENT.—The table of sections for subchapter B of chapter 65 is amended by adding at the end the following new item:

"Sec. 6428. Acceleration of 10 percent income tax rate bracket benefit for 2001.".

(c) CONFORMING AMENDMENTS.—

(1) Subparagraph (B) of section 1(g)(7) is amended by striking "15 percent" in clause (ii)(II) and inserting "10 percent.".

(2) Section 1(h) is amended—

(A) by striking "28 percent" both places it appears in paragraphs (1)(A)(ii)(I) and (1)(B)(i) and inserting "25 percent", and

(B) by striking paragraph (13).

(3) Section 15 is amended by adding at the end the following new subsection:

"(f) RATE REDUCTIONS ENACTED BY ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001.—This section shall not apply to any change in rates under subsection (i) of section 1 (relating to rate reductions after 2000).".

(4) Section 531 is amended by striking "equal to" and all that follows and inserting "equal to the product of the highest rate of tax under section 1(c) and the accumulated taxable income.".

(5) Section 541 is amended by striking "equal to" and all that follows and inserting "equal to the product of the highest rate of tax under section 1(c) and the undistributed personal holding company income.".

(6) Section 3402(p)(1)(B) is amended by striking "7, 15, 28, or 31 percent" and inserting "7 percent, any percentage applicable to any of the 3 lowest income brackets in the table under section 1(c),".

(7) Section 3402(p)(2) is amended by striking "15 percent" and inserting "10 percent".

(8) Section 3402(q)(1) is amended by striking "equal to 28 percent of such payment" and inserting "equal to the product of the third lowest rate of tax applicable under section 1(c) and such payment".

(9) Section 3402(r)(3) is amended by striking "31 percent" and inserting "the fourth lowest rate of tax applicable under section 1(c)".

(10) Section 3406(a)(1) is amended by striking "equal to 31 percent of such payment" and inserting "equal to the product of the fourth lowest rate of tax applicable under section 1(c) and such payment".

(11) Section 13273 of the Revenue Reconciliation Act of 1993 is amended by striking "28 percent" and inserting "the third lowest rate of tax applicable under section 1(c) of the Internal Revenue Code of 1986".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) AMENDMENTS TO WITHHOLDING PROVISIONS.—The amendments made by paragraphs (6), (7), (8), (9), (10), and (11) of subsection (c) shall apply to amounts paid after the 60th day after the date of the enactment of this Act. References to income brackets and rates of tax in such paragraphs shall be applied without regard to section 1(i)(1)(D) of the Internal Revenue Code of 1986.

SEC. 102. REPEAL OF PHASEOUT OF PERSONAL EXEMPTIONS.

(a) IN GENERAL.—Paragraph (3) of section 151(d) (relating to exemption amount) is amended by adding at the end the following new subparagraphs:

"(E) REDUCTION OF PHASEOUT.—

"(i) IN GENERAL.—In the case of taxable years beginning after December 31, 2005, and before January 1, 2010, the reduction under subparagraph (A) shall be

equal to the applicable fraction of the amount which would (but for this subparagraph) be the amount of such reduction.

"(ii) APPLICABLE FRACTION.—For purposes of clause (i), the applicable fraction shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable fraction is—***
2006 and 2007	*2/3*
2008 and 2009	*1/3.*

"(F) TERMINATION.—This paragraph shall not apply to any taxable year beginning after December 31, 2009.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2005.

SEC. 103. PHASEOUT OF OVERALL LIMITATION ON ITEMIZED DEDUCTIONS.

(a) IN GENERAL.—Section 68 is amended by adding at the end the following new subsections:

"(f) PHASEOUT OF LIMITATION.—

"(1) IN GENERAL.—In the case of taxable years beginning after December 31, 2005, and before January 1, 2010, the reduction under subsection (a) shall be equal to the applicable fraction of the amount which would (but for this subsection) be the amount of such reduction.

"(2) APPLICABLE FRACTION.—For purposes of paragraph (1), the applicable fraction shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable fraction is—***
2006 and 2007	*2/3*
2008 and 2009	*1/3.*

"(g) TERMINATION.—This section shall not apply to any taxable year beginning after December 31, 2009.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to taxable years beginning after December 31, 2005.

TITLE II—TAX BENEFITS RELATING TO CHILDREN

SEC. 201. MODIFICATIONS TO CHILD TAX CREDIT.

(a) INCREASE IN PER CHILD AMOUNT.—Subsection (a) of section 24 (relating to child tax credit) is amended to read as follows:

"(a) ALLOWANCE OF CREDIT.—

"(1) IN GENERAL.—There shall be allowed as a credit against the tax imposed by this chapter for the taxable year with respect to each qualifying child of the taxpayer an amount equal to the per child amount.

"(2) PER CHILD AMOUNT.—For purposes of paragraph (1), the per child amount shall be determined as follows:

"In the case of any taxable year beginning in—	***The per child amount is—***
2001, 2002, 2003, or 2004	*$ 600*
2005, 2006, 2007, or 2008	*700*
2009	*800*
2010 or thereafter	*1,000.".*

(b) CREDIT ALLOWED AGAINST ALTERNATIVE MINIMUM TAX.—

(1) IN GENERAL.—Subsection (b) of section 24 (relating to child tax credit) is amended by adding at the end the following new paragraph:

"(3) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess of—

"(A) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

"(B) the sum of the credits allowable under this subpart (other than this section) and section 27 for the taxable year.".

(2) CONFORMING AMENDMENTS.—

(A) The heading for section 24(b) is amended to read as follows: "LIMITATIONS.—".

(B) The heading for section 24(b)(1) is amended to read as follows: "LIMITATION BASED ON ADJUSTED GROSS INCOME.—".

(C) Section 24(d), as amended by subsection (c), is amended—

(i) by striking "section 26(a)" each place it appears and inserting "subsection (b)(3)", and

(ii) in paragraph (1)(B) by striking "aggregate amount of credits allowed by this subpart" and inserting "amount of credit allowed by this section".

(D) Paragraph (1) of section 26(a) is amended by inserting "(other than section 24)" after "this subpart".

(E) Subsection (c) of section 23 is amended by striking "and section 1400C" and inserting "and sections 24 and 1400C".

(F) Subparagraph (C) of section 25(e)(1) is amended by inserting ", 24," after "sections 23".

(G) Section 904(h) is amended by inserting "(other than section 24)" after "chapter".

(H) Subsection (d) of section 1400C is amended by inserting "and section 24" after "this section".

(c) REFUNDABLE CHILD CREDIT.—

(1) IN GENERAL.—So much of section 24(d) (relating to additional credit for families with 3 or more children) as precedes paragraph (2) is amended to read as follows:

"(d) PORTION OF CREDIT REFUNDABLE.—

"(1) IN GENERAL.—The aggregate credits allowed to a taxpayer under subpart C shall be increased by the lesser of—

"(A) the credit which would be allowed under this section without regard to this subsection and the limitation under section 26(a), or

"(B) the amount by which the amount of credit allowed by this section (determined without regard to this subsection) would increase if the limitation imposed by section 26(a) were increased by the greater of—

"(i) 15 percent (10 percent in the case of taxable years beginning before January 1, 2005) of so much of the taxpayer's earned income (within the meaning of section 32) which is taken into account in computing taxable income for the taxable year as exceeds $10,000, or

"(ii) in the case of a taxpayer with 3 or more qualifying children, the excess (if any) of—

"(I) the taxpayer's social security taxes for the taxable year, over

"(II) the credit allowed under section 32 for the taxable year.

The amount of the credit allowed under this subsection shall not be treated as a credit allowed under this subpart and shall reduce the amount of credit otherwise allowable under subsection (a) without regard to section 26(a).".

(2) INFLATION ADJUSTMENT.—Subsection (d) of section 24 is amended by adding at the end the following new paragraph:

"(4) INFLATION ADJUSTMENT.—In the case of any taxable year beginning in a calendar year after 2001, the $10,000 amount contained in paragraph (1)(B) shall be increased by an amount equal to—

"(A) such dollar amount, multiplied by

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2000' for 'calendar year 1992' in subparagraph (B) thereof.

Any increase determined under the preceding sentence shall be rounded to the nearest multiple of $50."

(3) CONFORMING AMENDMENT.—Section 32 is amended by striking subsection (n).

(d) ELIMINATION OF REDUCTION OF CREDIT TO TAXPAYER SUBJECT TO ALTERNATIVE MINIMUM TAX PROVISION.—Section 24(d) is amended—

(1) by striking paragraph (2), and

(2) by redesignating paragraphs (3) and (4) as paragraphs (2) and (3), respectively.

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2000.

(2) SUBSECTION (b).—The amendments made by subsection (b) shall apply to taxable years beginning after December 31, 2001.

SEC. 202. EXPANSION OF ADOPTION CREDIT AND ADOPTION ASSISTANCE PROGRAMS.

(a) IN GENERAL.—

(1) ADOPTION CREDIT.—Section 23(a)(1) (relating to allowance of credit) is amended to read as follows:

"(1) IN GENERAL.—In the case of an individual, there shall be allowed as a credit against the tax imposed by this chapter—

"(A) in the case of an adoption of a child other than a child with special needs, the amount of the qualified adoption expenses paid or incurred by the taxpayer, and

"(B) in the case of an adoption of a child with special needs, $10,000.".

(2) ADOPTION ASSISTANCE PROGRAMS.—Section 137(a) (relating to adoption assistance programs) is amended to read as follows:

"(a) IN GENERAL.—Gross income of an employee does not include amounts paid or expenses incurred by the employer for adoption expenses in connection with the adoption of a child by an employee if such amounts are furnished pursuant to an adoption assistance program. The amount of the exclusion shall be—

"(1) in the case of an adoption of a child other than a child with special needs, the amount of the qualified adoption expenses paid or incurred by the taxpayer, and

"(2) in the case of an adoption of a child with special needs, $10,000.".

(b) DOLLAR LIMITATIONS.—

(1) DOLLAR AMOUNT OF ALLOWED EXPENSES.—

(A) ADOPTION EXPENSES.—Section 23(b)(1) (relating to allowance of credit) is amended—

(i) by striking "$5,000" and inserting "$10,000",

(ii) by striking "($6,000, in the case of a child with special needs)", and

(iii) by striking "subsection (a)" and inserting "subsection (a)(1)(A)".

(B) ADOPTION ASSISTANCE PROGRAMS.—Section 137(b)(1) (relating to dollar limitations for adoption assistance programs) is amended—

(i) by striking "$5,000" and inserting "$10,000", and

(ii) by striking "($6,000, in the case of a child with special needs)", and

(iii) by striking "subsection (a)" and inserting "subsection (a)(1)".

(2) PHASE-OUT LIMITATION.—

(A) ADOPTION EXPENSES.—Clause (i) of section 23(b)(2)(A) (relating to income limitation) is amended by striking "$75,000" and inserting "$150,000".

(B) ADOPTION ASSISTANCE PROGRAMS.—Section 137(b)(2)(A) (relating to income limitation) is amended by striking "$75,000" and inserting "$150,000".

(c) YEAR CREDIT ALLOWED.—Section 23(a)(2) (relating to year credit allowed) is amended by adding at the end the following new flush sentence:

"In the case of the adoption of a child with special needs, the credit allowed under paragraph (1) shall be allowed for the taxable year in which the adoption becomes final.".

(d) REPEAL OF TERMINATIONS.—

(1) CHILDREN WITHOUT SPECIAL NEEDS.—Paragraph (2) of section 23(d) (relating to definition of eligible child) is amended to read as follows:

"(2) ELIGIBLE CHILD.—The term 'eligible child' means any individual who—

"(A) has not attained age 18, or

"(B) is physically or mentally incapable of caring for himself.".

(2) ADOPTION ASSISTANCE PROGRAMS.—Section 137 (relating to adoption assistance programs) is amended by striking subsection (f).

(e) ADJUSTMENT OF DOLLAR AND INCOME LIMITATIONS FOR INFLATION.—

(1) ADOPTION CREDIT.—Section 23 (relating to adoption expenses) is amended by redesignating subsection (h) as subsection (i) and by inserting after subsection (g) the following new subsection:

"(h) ADJUSTMENTS FOR INFLATION.—In the case of a taxable year beginning after December 31, 2002, each of the dollar amounts in subsection (a)(1)(B) and paragraphs (1) and (2)(A)(i) of subsection (b) shall be increased by an amount equal to—

"(1) such dollar amount, multiplied by

"(2) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof.".

(2) ADOPTION ASSISTANCE PROGRAMS.—Section 137 (relating to adoption assistance programs), as amended by subsection (d), is amended by adding at the end the following new subsection:

"(f) ADJUSTMENTS FOR INFLATION.—In the case of a taxable year beginning after December 31, 2002, each of the dollar amounts in subsection (a)(2) and paragraphs (1) and (2)(A) of subsection (b) shall be increased by an amount equal to—

"(1) such dollar amount, multiplied by

"(2) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2001' for 'calendar year 1992' in subparagraph (B) thereof.".

(f) CREDIT ALLOWED AGAINST ALTERNATIVE MINIMUM TAX.—

(1) IN GENERAL.—Subsection (b) of section 23 is amended by adding at the end the following new paragraph:

"(4) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under subsection (a) for any taxable year shall not exceed the excess of—

"(A) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

"(B) the sum of the credits allowable under this subpart (other than this section) and section 27 for the taxable year."

(2) CONFORMING AMENDMENTS.—

(A) Section 23(c), as amended by section 201(b), is amended—

(i) by striking "section 26(a)" and inserting "subsection (b)(4)", and

(ii) by striking "reduced by the sum of the credits allowable under this subpart (other than this section and sections 24 and 1400C)".

(B) Section 24(b)(3)(B), as added by section 201(b), is amended by striking "this section" and inserting "this section and section 23".

(C) Sections 26(a)(1), 904(h), and 1400C(d), as amended by section 201(b), are each amended by striking "section 24" and inserting "sections 23 and 24".

(g) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2001.

(2) SUBSECTION (a).—The amendments made by subsection (a) shall apply to taxable years beginning after December 31, 2002.

SEC. 203. REFUNDS DISREGARDED IN THE ADMINISTRATION OF FEDERAL PROGRAMS AND FEDERALLY ASSISTED PROGRAMS.

Any payment considered to have been made to any individual by reason of section 24 of the Internal Revenue Code of 1986, as amended by section 201, shall not be taken into account as income and shall not be taken into account as resources for the month of receipt and the following month, for purposes of determining the eligibility of such individual or any other individual for benefits or assistance, or the amount or extent of benefits or assistance, under any Federal program or under any State or local program financed in whole or in part with Federal funds.

SEC. 204. DEPENDENT CARE CREDIT.

(a) INCREASE IN DOLLAR LIMIT.—Subsection (c) of section 21 (relating to expenses for household and dependent care services necessary for gainful employment) is amended—

(1) by striking "$2,400" in paragraph (1) and inserting "$3,000", and

(2) by striking "$4,800" in paragraph (2) and inserting "$6,000".

(b) INCREASE IN APPLICABLE PERCENTAGE.—Section 21(a)(2) (defining applicable percentage) is amended—

(1) by striking "30 percent" and inserting "35 percent", and

(2) by striking "$10,000" and inserting "$15,000".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2002.

SEC. 205. ALLOWANCE OF CREDIT FOR EMPLOYER EXPENSES FOR CHILD CARE ASSISTANCE.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 (relating to business related credits), as amended by section 619, is further amended by adding at the end the following:

"SEC. 45F. EMPLOYER-PROVIDED CHILD CARE CREDIT.

"(a) IN GENERAL.—For purposes of section 38, the employer-provided child care credit determined under this section for the taxable year is an amount equal to the sum of—

"(1) 25 percent of the qualified child care expenditures, and

"(2) 10 percent of the qualified child care resource and referral expenditures,

of the taxpayer for such taxable year.

"(b) DOLLAR LIMITATION.—The credit allowable under subsection (a) for any taxable year shall not exceed $150,000.

"(c) DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED CHILD CARE EXPENDITURE.—

"(A) IN GENERAL.—The term 'qualified child care expenditure' means any amount paid or incurred—

"(i) to acquire, construct, rehabilitate, or expand property—

"(I) which is to be used as part of a qualified child care facility of the taxpayer,

"(II) with respect to which a deduction for depreciation (or amortization in lieu of depreciation) is allowable, and

"(III) which does not constitute part of the principal residence (within the meaning of section 121) of the taxpayer or any employee of the taxpayer,

"(ii) for the operating costs of a qualified child care facility of the taxpayer, including costs related to the training of employees, to scholarship programs, and to the providing of increased compensation to employees with higher levels of child care training, or

"(iii) under a contract with a qualified child care facility to provide child care services to employees of the taxpayer.

"(B) FAIR MARKET VALUE.—The term 'qualified child care expenditures' shall not include expenses in excess of the fair market value of such care.

"(2) QUALIFIED CHILD CARE FACILITY.—

"(A) IN GENERAL.—The term 'qualified child care facility' means a facility—

"(i) the principal use of which is to provide child care assistance, and

"(ii) which meets the requirements of all applicable laws and regulations of the State or local government in which it is located, including the licensing of the facility as a child care facility.

Clause (i) shall not apply to a facility which is the principal residence (within the meaning of section 121) of the operator of the facility.

"(B) SPECIAL RULES WITH RESPECT TO A TAXPAYER.—A facility shall not be treated as a qualified child care facility with respect to a taxpayer unless—

"(i) enrollment in the facility is open to employees of the taxpayer during the taxable year,

"(ii) if the facility is the principal trade or business of the taxpayer, at least 30 percent of the enrollees of such facility are dependents of employees of the taxpayer, and

"(iii) the use of such facility (or the eligibility to use such facility) does not discriminate in favor of employees of the taxpayer who are highly compensated employees (within the meaning of section 414(q)).

"(3) QUALIFIED CHILD CARE RESOURCE AND REFERRAL EXPENDITURE.—

"(A) IN GENERAL.—The term 'qualified child care resource and referral expenditure' means any amount paid or incurred under a contract to provide child care resource and referral services to an employee of the taxpayer.

"(B) NONDISCRIMINATION.—The services shall not be treated as qualified unless the provision of such services (or the eligibility to use such services) does not discriminate in favor of employees of the taxpayer who are highly compensated employees (within the meaning of section 414(q)).

"(d) RECAPTURE OF ACQUISITION AND CONSTRUCTION CREDIT.—

"(1) IN GENERAL.—If, as of the close of any taxable year, there is a recapture event with respect to any qualified child care facility of the taxpayer, then the tax of the taxpayer under

this chapter for such taxable year shall be increased by an amount equal to the product of—

"(A) the applicable recapture percentage, and

"(B) the aggregate decrease in the credits allowed under section 38 for all prior taxable years which would have resulted if the qualified child care expenditures of the taxpayer described in subsection (c)(1)(A) with respect to such facility had been zero.

"(2) APPLICABLE RECAPTURE PERCENTAGE.—

"(A) IN GENERAL.—For purposes of this subsection, the applicable recapture percentage shall be determined from the following table:

"If the recapture event occurs in:	***The applicable recapture percentage is:***
Years 1–3	*100*
Year 4	*85*
Year 5	*70*
Year 6	*55*
Year 7	*40*
Year 8	*25*
Years 9 and 10	*10*
Years 11 and thereafter	*0.*

"(B) YEARS.—For purposes of subparagraph (A), year 1 shall begin on the first day of the taxable year in which the qualified child care facility is placed in service by the taxpayer.

"(3) RECAPTURE EVENT DEFINED.—For purposes of this subsection, the term 'recapture event' means—

"(A) CESSATION OF OPERATION.—The cessation of the operation of the facility as a qualified child care facility.

"(B) CHANGE IN OWNERSHIP.—

"(i) IN GENERAL.—Except as provided in clause (ii), the disposition of a taxpayer's interest in a qualified child care facility with respect to which the credit described in subsection (a) was allowable.

"(ii) AGREEMENT TO ASSUME RECAPTURE LIABILITY.—Clause (i) shall not apply if the person acquiring such interest in the facility agrees in writing to assume the recapture liability of the person disposing of such interest in effect immediately before such disposition. In the event of such an assumption, the person acquiring the interest in the facility shall be treated as the taxpayer for purposes of assessing any recapture liability (computed as if there had been no change in ownership).

"(4) SPECIAL RULES.—

"(A) TAX BENEFIT RULE.—The tax for the taxable year shall be increased under paragraph (1) only with respect to credits allowed by reason of this section which were used to reduce tax liability. In the case of credits not so used to reduce tax liability, the carryforwards and carrybacks under section 39 shall be appropriately adjusted.

"(B) NO CREDITS AGAINST TAX.—Any increase in tax under this subsection shall not be treated as a tax imposed by this chapter for purposes of determining the amount of any credit under subpart A, B, or D of this part.

"(C) NO RECAPTURE BY REASON OF CASUALTY LOSS.—The increase in tax under this subsection shall not apply to a cessation of operation of the facility as a qualified child care facility by reason of a casualty loss to the extent such loss is restored by reconstruction or replacement within a reasonable period established by the Secretary.

"(e) SPECIAL RULES.—For purposes of this section—

"(1) AGGREGATION RULES.—All persons which are treated as a single employer under subsections (a) and (b) of section 52 shall be treated as a single taxpayer.

"(2) PASS-THRU IN THE CASE OF ESTATES AND TRUSTS.—Under regulations prescribed by the Secretary, rules similar to the rules of subsection (d) of section 52 shall apply.

"(3) ALLOCATION IN THE CASE OF PARTNERSHIPS.—In the case of partnerships, the credit shall be allocated among partners under regulations prescribed by the Secretary.

"(f) NO DOUBLE BENEFIT.—

"(1) REDUCTION IN BASIS.—For purposes of this subtitle—

"(A) IN GENERAL.—If a credit is determined under this section with respect to any property by reason of expenditures described in subsection (c)(1)(A), the basis of such property shall be reduced by the amount of the credit so determined.

"(B) CERTAIN DISPOSITIONS.—If, during any taxable year, there is a recapture amount determined with respect to any property the basis of which was reduced under subparagraph (A), the basis of such property (immediately before the event resulting in such recapture) shall be increased by an amount equal to such recapture amount. For purposes of the preceding sentence, the term 'recapture amount' means any increase in tax (or adjustment in carrybacks or carryovers) determined under subsection (d).

"(2) OTHER DEDUCTIONS AND CREDITS.—No deduction or credit shall be allowed under any other provision of this chapter with respect to the amount of the credit determined under this section.".

(b) CONFORMING AMENDMENTS.—

(1) Section 38(b), as amended by section 619, is amended by striking "plus" at the end of paragraph (13), by striking the period at the end of paragraph (14) and inserting ", plus", and by adding at the end the following:

"(15) the employer-provided child care credit determined under section 45F.".

(2) The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following:

"Sec. 45F. Employer-provided child care credit."

(3) Section 1016(a) is amended by striking "and" at the end of paragraph (26), by striking the period at the end of paragraph (27) and inserting ", and", and by adding at the end the following:

"(28) in the case of a facility with respect to which a credit was allowed under section 45F, to the extent provided in section 45F(f)(1).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

TITLE III—MARRIAGE PENALTY RELIEF

SEC. 301. ELIMINATION OF MARRIAGE PENALTY IN STANDARD DEDUCTION.

(a) IN GENERAL.—Paragraph (2) of section 63(c) (relating to standard deduction) is amended—

(1) by striking "$5,000" in subparagraph (A) and inserting "the applicable percentage of the dollar amount in effect under subparagraph (C) for the taxable year";

(2) by adding "or" at the end of subparagraph (B);

(3) by striking "in the case of" and all that follows in subparagraph (C) and inserting "in any other case."; and

(4) by striking subparagraph (D).

(b) APPLICABLE PERCENTAGE.—Section 63(c) (relating to standard deduction) is amended by adding at the end the following new paragraph:

"(7) APPLICABLE PERCENTAGE.—For purposes of paragraph (2), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2005	*174*
2006	*184*
2007	*187*
2008	*190*
2009 and thereafter	*200.".*

(c) TECHNICAL AMENDMENTS.—

(1) Subparagraph (B) of section 1(f)(6) is amended by striking "(other than with" and all that follows through "shall be applied" and inserting "(other than with respect to sections 63(c)(4) and 151(d)(4)(A)) shall be applied".

(2) Paragraph (4) of section 63(c) is amended by adding at the end the following flush sentence:

"The preceding sentence shall not apply to the amount referred to in paragraph (2)(A).".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

SEC. 302. PHASEOUT OF MARRIAGE PENALTY IN 15-PERCENT BRACKET.

(a) IN GENERAL.—Section 1(f) (relating to adjustments in tax tables so that inflation will not result in tax increases) is amended by adding at the end the following new paragraph:

"(8) PHASEOUT OF MARRIAGE PENALTY IN 15-PERCENT BRACKET.—

"(A) IN GENERAL.—With respect to taxable years beginning after December 31, 2004, in prescribing the tables under paragraph (1)—

"(i) the maximum taxable income in the 15-percent rate bracket in the table contained in subsection (a) (and the minimum taxable income in the next higher taxable income bracket in such table) shall be the applicable percentage of the maximum taxable income in the 15-percent rate bracket in the table contained in

subsection (c) (after any other adjustment under this subsection), and

"(ii) the comparable taxable income amounts in the table contained in subsection (d) shall be ½ of the amounts determined under clause (i).

"(B) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A), the applicable percentage shall be determined in accordance with the following table:

"For taxable years beginning in calendar year—	***The applicable percentage is—***
2005	*180*
2006	*187*
2007	*193*
2008 and thereafter	*200.*

"(C) ROUNDING.—If any amount determined under subparagraph (A)(i) is not a multiple of $50, such amount shall be rounded to the next lowest multiple of $50.".

(b) TECHNICAL AMENDMENTS.—

(1) Subparagraph (A) of section 1(f)(2) is amended by inserting "except as provided in paragraph (8)," before "by increasing".

(2) The heading for subsection (f) of section 1 is amended by inserting "PHASEOUT OF MARRIAGE PENALTY IN 15-PERCENT BRACKET;" before "ADJUSTMENTS".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

SEC. 303. MARRIAGE PENALTY RELIEF FOR EARNED INCOME CREDIT; EARNED INCOME TO INCLUDE ONLY AMOUNTS INCLUDIBLE IN GROSS INCOME; SIMPLIFICATION OF EARNED INCOME CREDIT.

(a) INCREASED PHASEOUT AMOUNT.—

(1) IN GENERAL.—Section 32(b)(2) (relating to amounts) is amended—

(A) by striking "AMOUNTS.—The earned" and inserting "AMOUNTS.—

"(A) IN GENERAL.—Subject to subparagraph (B), the earned", and

(B) by adding at the end the following new subparagraph:

"(B) JOINT RETURNS.—In the case of a joint return filed by an eligible individual and such individual's spouse, the phaseout amount determined under subparagraph (A) shall be increased by—

"(i) $1,000 in the case of taxable years beginning in 2002, 2003, and 2004,

"(ii) $2,000 in the case of taxable years beginning in 2005, 2006, and 2007, and

"(iii) $3,000 in the case of taxable years beginning after 2007.".

(2) INFLATION ADJUSTMENT.—Paragraph (1)(B) of section 32(j) (relating to inflation adjustments) is amended to read as follows:

"(B) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined—

"(i) in the case of amounts in subsections (b)(2)(A) and (i)(1), by substituting 'calendar year 1995' for 'calendar year 1992' in subparagraph (B) thereof, and

"(ii) in the case of the $3,000 amount in subsection (b)(2)(B)(iii), by substituting 'calendar year 2007' for 'calendar year 1992' in subparagraph (B) of such section 1.".

(3) ROUNDING.—Section 32(j)(2)(A) (relating to rounding) is amended by striking "subsection (b)(2)" and inserting "subsection (b)(2)(A) (after being increased under subparagraph (B) thereof)".

(b) EARNED INCOME TO INCLUDE ONLY AMOUNTS INCLUDIBLE IN GROSS INCOME.—Clause (i) of section 32(c)(2)(A) (defining earned income) is amended by inserting ", but only if such amounts are includible in gross income for the taxable year" after "other employee compensation".

(c) REPEAL OF REDUCTION OF CREDIT TO TAXPAYERS SUBJECT TO ALTERNATIVE MINIMUM TAX.—Section 32(h) is repealed.

(d) REPLACEMENT OF MODIFIED ADJUSTED GROSS INCOME WITH ADJUSTED GROSS INCOME.—

(1) IN GENERAL.—Section 32(a)(2)(B) is amended by striking "modified".

(2) CONFORMING AMENDMENTS.—

(A) Section 32(c) is amended by striking paragraph (5).

(B) Section 32(f)(2)(B) is amended by striking "modified" each place it appears.

(e) RELATIONSHIP TEST.—

(1) IN GENERAL.—Clause (i) of section 32(c)(3)(B) (relating to relationship test) is amended to read as follows:

"(i) IN GENERAL.—An individual bears a relationship to the taxpayer described in this subparagraph if such individual is—

"(I) a son, daughter, stepson, or stepdaughter, or a descendant of any such individual,

"(II) a brother, sister, stepbrother, or stepsister, or a descendant of any such individual, who the taxpayer cares for as the taxpayer's own child, or

"(III) an eligible foster child of the taxpayer.".

(2) ELIGIBLE FOSTER CHILD.—

(A) IN GENERAL.—Clause (iii) of section 32(c)(3)(B) is amended to read as follows:

"(iii) ELIGIBLE FOSTER CHILD.—For purposes of clause (i), the term 'eligible foster child' means an individual not described in subclause (I) or (II) of clause (i) who—

"(I) is placed with the taxpayer by an authorized placement agency, and

"(II) the taxpayer cares for as the taxpayer's own child.".

(B) CONFORMING AMENDMENT.—Section 32(c)(3)(A)(ii) is amended by striking "except as provided in subparagraph (B)(iii),".

(f) 2 OR MORE CLAIMING QUALIFYING CHILD.—Section 32(c)(1)(C) is amended to read as follows:

"(C) 2 OR MORE CLAIMING QUALIFYING CHILD.—

"(i) IN GENERAL.—Except as provided in clause (ii), if (but for this paragraph) an individual may be claimed, and is claimed, as a qualifying child by 2 or more taxpayers for a taxable year beginning in the same calendar year, such individual shall be treated as the qualifying child of the taxpayer who is—

"(I) a parent of the individual, or

"(II) if subclause (I) does not apply, the taxpayer with the highest adjusted gross income for such taxable year.

"(ii) MORE THAN 1 CLAIMING CREDIT.—If the parents claiming the credit with respect to any qualifying child do not file a joint return together, such child shall be treated as the qualifying child of—

"(I) the parent with whom the child resided for the longest period of time during the taxable year, or

"(II) if the child resides with both parents for the same amount of time during such taxable year, the parent with the highest adjusted gross income.".

(g) EXPANSION OF MATHEMATICAL ERROR AUTHORITY.—Paragraph (2) of section 6213(g) is amended by striking "and" at the end of subparagraph (K), by striking the period at the end of subparagraph (L) and inserting ", and", and by inserting after subparagraph (L) the following new subparagraph:

"(M) the entry on the return claiming the credit under section 32 with respect to a child if, according to the Federal Case Registry of Child Support Orders established under section 453(h) of the Social Security Act, the taxpayer is a noncustodial parent of such child."

(h) CLERICAL AMENDMENT.—Subparagraph (E) of section 32(c)(3) is amended by striking "subparagraphs (A)(ii) and (B)(iii)(II)" and inserting "subparagraph (A)(ii)".

(i) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to taxable years beginning after December 31, 2001.

(2) SUBSECTION (g).—The amendment made by subsection (g) shall take effect on January 1, 2004.

TITLE IV—AFFORDABLE EDUCATION PROVISIONS

Subtitle A—Education Savings Incentives

SEC. 401. MODIFICATIONS TO EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.

(a) MAXIMUM ANNUAL CONTRIBUTIONS.—

(1) IN GENERAL.—Section 530(b)(1)(A)(iii) (defining education individual retirement account) is amended by striking "$500" and inserting "$2,000".

(2) CONFORMING AMENDMENT.—Section 4973(e)(1)(A) is amended by striking "$500" and inserting "$2,000".

(b) MODIFICATION OF AGI LIMITS TO REMOVE MARRIAGE PENALTY.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) is amended—

(1) by striking "$150,000" in subparagraph (A)(ii) and inserting "$190,000", and

(2) by striking "$10,000" in subparagraph (B) and inserting "$30,000".

(c) TAX-FREE EXPENDITURES FOR ELEMENTARY AND SECONDARY SCHOOL EXPENSES.—

(1) IN GENERAL.—Section 530(b)(2) (defining qualified higher education expenses) is amended to read as follows:

"(2) QUALIFIED EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified education expenses' means—

"(i) qualified higher education expenses (as defined in section 529(e)(3)), and

"(ii) qualified elementary and secondary education expenses (as defined in paragraph (4)).

"(B) QUALIFIED STATE TUITION PROGRAMS.—Such term shall include any contribution to a qualified State tuition program (as defined in section 529(b)) on behalf of the designated beneficiary (as defined in section 529(e)(1)); but there shall be no increase in the investment in the contract for purposes of applying section 72 by reason of any portion of such contribution which is not includible in gross income by reason of subsection (d)(2).".

(2) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—Section 530(b) (relating to definitions and special rules) is amended by adding at the end the following new paragraph:

"(4) QUALIFIED ELEMENTARY AND SECONDARY EDUCATION EXPENSES.—

"(A) IN GENERAL.—The term 'qualified elementary and secondary education expenses' means—

"(i) expenses for tuition, fees, academic tutoring, special needs services in the case of a special needs beneficiary, books, supplies, and other equipment which are incurred in connection with the enrollment or attendance of the designated beneficiary of the trust as an elementary or secondary school student at a public, private, or religious school,

"(ii) expenses for room and board, uniforms, transportation, and supplementary items and services (including extended day programs) which are required or provided by a public, private, or religious school in connection with such enrollment or attendance, and

"(iii) expenses for 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 school.

Clause (iii) shall not include expenses for computer software designed for sports, games, or hobbies unless the software is predominantly educational in nature.

"(B) SCHOOL.—The term 'school' means any school which provides elementary education or secondary edu-

cation (kindergarten through grade 12), as determined under State law.".

(3) CONFORMING AMENDMENTS.—Section 530 is amended—

(A) by striking "higher" each place it appears in subsections (b)(1) and (d)(2), and

(B) by striking "HIGHER" in the heading for subsection (d)(2).

(d) WAIVER OF AGE LIMITATIONS FOR CHILDREN WITH SPECIAL NEEDS.—Section 530(b)(1) (defining education individual retirement account) is amended by adding at the end the following flush sentence:

"The age limitations in subparagraphs (A)(ii) and (E), and paragraphs (5) and (6) of subsection (d), shall not apply to any designated beneficiary with special needs (as determined under regulations prescribed by the Secretary).".

(e) ENTITIES PERMITTED TO CONTRIBUTE TO ACCOUNTS.—Section 530(c)(1) (relating to reduction in permitted contributions based on adjusted gross income) is amended by striking "The maximum amount which a contributor" and inserting "In the case of a contributor who is an individual, the maximum amount the contributor".

(f) TIME WHEN CONTRIBUTIONS DEEMED MADE.—

(1) IN GENERAL.—Section 530(b) (relating to definitions and special rules), as amended by subsection (c)(2), is amended by adding at the end the following new paragraph:

"(5) TIME WHEN CONTRIBUTIONS DEEMED MADE.—An individual shall be deemed to have made a contribution to an education individual retirement account on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the return for such taxable year (not including extensions thereof).".

(2) EXTENSION OF TIME TO RETURN EXCESS CONTRIBUTIONS.—Subparagraph (C) of section 530(d)(4) (relating to additional tax for distributions not used for educational expenses) is amended—

(A) by striking clause (i) and inserting the following new clause:

"(i) such distribution is made before the first day of the sixth month of the taxable year following the taxable year, and", and

(B) by striking "DUE DATE OF RETURN" in the heading and inserting "CERTAIN DATE".

(g) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 530(d)(2)(C) is amended to read as follows:

"(C) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS AND QUALIFIED TUITION PROGRAMS.—For purposes of subparagraph (A)—

"(i) CREDIT COORDINATION.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit

allowed to the taxpayer or any other person under section 25A.

"(ii) COORDINATION WITH QUALIFIED TUITION PROGRAMS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions during such year to which subparagraph (A) and section 529(c)(3)(B) apply, exceed

"(II) the total amount of qualified education expenses (after the application of clause (i)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under subparagraph (A) and section 529(c)(3)(B).".

(2) CONFORMING AMENDMENTS.—

(A) Subsection (e) of section 25A is amended to read as follows:

"(e) ELECTION NOT TO HAVE SECTION APPLY.—A taxpayer may elect not to have this section apply with respect to the qualified tuition and related expenses of an individual for any taxable year.".

(B) Section 135(d)(2)(A) is amended by striking "allowable" and inserting "allowed".

(C) Section 530(d)(2)(D) is amended—

(i) by striking "or credit" and inserting ", credit, or exclusion", and

(ii) by striking "CREDIT OR DEDUCTION" in the heading and inserting "DEDUCTION, CREDIT, OR EXCLUSION".

(D) Section 4973(e)(1) is amended by adding "and" at the end of subparagraph (A), by striking subparagraph (B), and by redesignating subparagraph (C) as subparagraph (B).

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 402. MODIFICATIONS TO QUALIFIED TUITION PROGRAMS.

(a) ELIGIBLE EDUCATIONAL INSTITUTIONS PERMITTED TO MAINTAIN QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(b)(1) (defining qualified State tuition program) is amended—

(A) by inserting "or by 1 or more eligible educational institutions" after "maintained by a State or agency or instrumentality thereof" in the matter preceding subparagraph (A), and

(B) by adding at the end the following new flush sentence:

"Except to the extent provided in regulations, a program established and maintained by 1 or more eligible educational institutions shall not be treated as a qualified tuition program unless such program provides that amounts are held in a qualified trust and such program has received a ruling or determination that such program meets the applicable requirements for a qualified tuition program. For purposes of the preceding sentence, the term 'qualified trust' means a trust which is created

or organized in the United States for the exclusive benefit of designated beneficiaries and with respect to which the requirements of paragraphs (2) and (5) of section 408(a) are met.".

(2) PRIVATE QUALIFIED TUITION PROGRAMS LIMITED TO BENEFIT PLANS.—Clause (ii) of section 529(b)(1)(A) is amended by inserting "in the case of a program established and maintained by a State or agency or instrumentality thereof," before "may make".

(3) ADDITIONAL TAX ON NONQUALIFIED WITHDRAWALS.—Section 529 is amended—

(A) by striking paragraph (3) of subsection (b) and by redesignating paragraphs (4), (5), (6), and (7) of such subsection as paragraphs (3), (4), (5), and (6), respectively, and

(B) by adding at the end of subsection (c) the following new paragraph:

"(6) ADDITIONAL TAX.—The tax imposed by section 530(d)(4) shall apply to any payment or distribution from a qualified tuition program in the same manner as such tax applies to a payment or distribution from an education individual retirement account. This paragraph shall not apply to any payment or distribution in any taxable year beginning before January 1, 2004, which is includible in gross income but used for qualified higher education expenses of the designated beneficiary.".

(4) CONFORMING AMENDMENTS.—

(A) Sections 72(e)(9), 135(c)(2)(C), 135(d)(1)(D), 529, 530(b)(2)(B), 4973(e), and 6693(a)(2)(C) are amended by striking "qualified State tuition" each place it appears and inserting "qualified tuition".

(B) The headings for sections 72(e)(9) and 135(c)(2)(C) are amended by striking "QUALIFIED STATE TUITION" each place it appears and inserting "QUALIFIED TUITION".

(C) The headings for sections 529(b) and 530(b)(2)(B) are amended by striking "QUALIFIED STATE TUITION" each place it appears and inserting "QUALIFIED TUITION".

*(D) The heading for section 529 is amended by striking "**STATE**".*

(E) The item relating to section 529 in the table of sections for part VIII of subchapter F of chapter 1 is amended by striking "State".

(b) EXCLUSION FROM GROSS INCOME OF EDUCATION DISTRIBUTIONS FROM QUALIFIED TUITION PROGRAMS.—

(1) IN GENERAL.—Section 529(c)(3)(B) (relating to distributions) is amended to read as follows:

"(B) DISTRIBUTIONS FOR QUALIFIED HIGHER EDUCATION EXPENSES.—For purposes of this paragraph—

"(i) IN-KIND DISTRIBUTIONS.—No amount shall be includible in gross income under subparagraph (A) by reason of a distribution which consists of providing a benefit to the distributee which, if paid for by the distributee, would constitute payment of a qualified higher education expense.

"(ii) CASH DISTRIBUTIONS.—In the case of distributions not described in clause (i), if—

"(I) such distributions do not exceed the qualified higher education expenses (reduced by ex-

penses described in clause (i)), no amount shall be includible in gross income, and

"(II) in any other case, the amount otherwise includible in gross income shall be reduced by an amount which bears the same ratio to such amount as such expenses bear to such distributions.

"(iii) EXCEPTION FOR INSTITUTIONAL PROGRAMS.—In the case of any taxable year beginning before January 1, 2004, clauses (i) and (ii) shall not apply with respect to any distribution during such taxable year under a qualified tuition program established and maintained by 1 or more eligible educational institutions.

"(iv) TREATMENT AS DISTRIBUTIONS.—Any benefit furnished to a designated beneficiary under a qualified tuition program shall be treated as a distribution to the beneficiary for purposes of this paragraph.

"(v) COORDINATION WITH HOPE AND LIFETIME LEARNING CREDITS.—The total amount of qualified higher education expenses with respect to an individual for the taxable year shall be reduced—

"(I) as provided in section 25A(g)(2), and

"(II) by the amount of such expenses which were taken into account in determining the credit allowed to the taxpayer or any other person under section 25A.

"(vi) COORDINATION WITH EDUCATION INDIVIDUAL RETIREMENT ACCOUNTS.—If, with respect to an individual for any taxable year—

"(I) the aggregate distributions to which clauses (i) and (ii) and section 530(d)(2)(A) apply, exceed

"(II) the total amount of qualified higher education expenses otherwise taken into account under clauses (i) and (ii) (after the application of clause (v)) for such year,

the taxpayer shall allocate such expenses among such distributions for purposes of determining the amount of the exclusion under clauses (i) and (ii) and section 530(d)(2)(A).".

(2) CONFORMING AMENDMENTS.—

(A) Section 135(d)(2)(B) is amended by striking "the exclusion under section 530(d)(2)" and inserting "the exclusions under sections 529(c)(3)(B) and 530(d)(2)".

(B) Section 221(e)(2)(A) is amended by inserting "529," after "135,".

(c) ROLLOVER TO DIFFERENT PROGRAM FOR BENEFIT OF SAME DESIGNATED BENEFICIARY.—Section 529(c)(3)(C) (relating to change in beneficiaries) is amended—

(1) by striking "transferred to the credit" in clause (i) and inserting "transferred—

"(I) to another qualified tuition program for the benefit of the designated beneficiary, or

"(II) to the credit",

(2) by adding at the end the following new clause:

"(iii) LIMITATION ON CERTAIN ROLLOVERS.—Clause (i)(I) shall not apply to any transfer if such transfer occurs within 12 months from the date of a previous transfer to any qualified tuition program for the benefit of the designated beneficiary.", and

(3) by inserting "OR PROGRAMS" after "BENEFICIARIES" in the heading.

(d) MEMBER OF FAMILY INCLUDES FIRST COUSIN.—Section 529(e)(2) (defining member of family) is amended by striking "and" at the end of subparagraph (B), by striking the period at the end of subparagraph (C) and by inserting "; and", and by adding at the end the following new subparagraph:

"(D) any first cousin of such beneficiary.".

(e) ADJUSTMENT OF LIMITATION ON ROOM AND BOARD DISTRIBUTIONS.—Section 529(e)(3)(B)(ii) is amended to read as follows:

"(ii) LIMITATION.—The amount treated as qualified higher education expenses by reason of clause (i) shall not exceed—

"(I) the allowance (applicable to the student) for room and board included in the cost of attendance (as defined in section 472 of the Higher Education Act of 1965 (20 U.S.C. 1087ll), as in effect on the date of the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001) as determined by the eligible educational institution for such period, or

"(II) if greater, the actual invoice amount the student residing in housing owned or operated by the eligible educational institution is charged by such institution for room and board costs for such period.".

(f) SPECIAL NEEDS SERVICES.—Subparagraph (A) of section 529(e)(3) (defining qualified higher education expenses) is amended to read as follows:

"(A) IN GENERAL.—The term 'qualified higher education expenses' means—

"(i) tuition, fees, books, supplies, and equipment required for the enrollment or attendance of a designated beneficiary at an eligible educational institution; and

"(ii) expenses for special needs services in the case of a special needs beneficiary which are incurred in connection with such enrollment or attendance.".

(g) TECHNICAL AMENDMENTS.—Section 529(c)(3)(D) is amended—

(1) by inserting "except to the extent provided by the Secretary," before "all distributions" in clause (ii), and

(2) by inserting "except to the extent provided by the Secretary," before "the value" in clause (iii).

(h) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

Subtitle B—Educational Assistance

SEC. 411. EXTENSION OF EXCLUSION FOR EMPLOYER-PROVIDED EDUCATIONAL ASSISTANCE.

(a) IN GENERAL.—Section 127 (relating to exclusion for educational assistance programs) is amended by striking subsection (d) and by redesignating subsection (e) as subsection (d).

(b) REPEAL OF LIMITATION ON GRADUATE EDUCATION.—The last sentence of section 127(c)(1) is amended by striking ", and such term also does not include any payment for, or the provision of any benefits with respect to, any graduate level course of a kind normally taken by an individual pursuing a program leading to a law, business, medical, or other advanced academic or professional degree".

(c) CONFORMING AMENDMENT.—Section 51A(b)(5)(B)(iii) is amended by striking "or would be so excludable but for section 127(d)".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply with respect to expenses relating to courses beginning after December 31, 2001.

SEC. 412. ELIMINATION OF 60-MONTH LIMIT AND INCREASE IN INCOME LIMITATION ON STUDENT LOAN INTEREST DEDUCTION.

(a) ELIMINATION OF 60-MONTH LIMIT.—

(1) IN GENERAL.—Section 221 (relating to interest on education loans), as amended by section 402(b)(2)(B), is amended by striking subsection (d) and by redesignating subsections (e), (f), and (g) as subsections (d), (e), and (f), respectively.

(2) CONFORMING AMENDMENT.—Section 6050S(e) is amended by striking "section 221(e)(1)" and inserting "section 221(d)(1)".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply with respect to any loan interest paid after December 31, 2001, in taxable years ending after such date.

(b) INCREASE IN INCOME LIMITATION.—

(1) IN GENERAL.—Section 221(b)(2)(B) (relating to amount of reduction) is amended by striking clauses (i) and (ii) and inserting the following:

"(i) the excess of—

"(I) the taxpayer's modified adjusted gross income for such taxable year, over

"(II) $50,000 ($100,000 in the case of a joint return), bears to

"(ii) $15,000 ($30,000 in the case of a joint return).".

(2) CONFORMING AMENDMENT.—Section 221(g)(1) is amended by striking "$40,000 and $60,000 amounts" and inserting "$50,000 and $100,000 amounts".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to taxable years ending after December 31, 2001.

SEC. 413. EXCLUSION OF CERTAIN AMOUNTS RECEIVED UNDER THE NATIONAL HEALTH SERVICE CORPS SCHOLARSHIP PROGRAM AND THE F. EDWARD HEBERT ARMED FORCES HEALTH PROFESSIONS SCHOLARSHIP AND FINANCIAL ASSISTANCE PROGRAM.

(a) IN GENERAL.—Section 117(c) (relating to the exclusion from gross income amounts received as a qualified scholarship) is amended—

(1) by striking "Subsections (a)" and inserting the following:

"(1) IN GENERAL.—Except as provided in paragraph (2), subsections (a)", and

(2) by adding at the end the following new paragraph:

"(2) EXCEPTIONS.—Paragraph (1) shall not apply to any amount received by an individual under—

"(A) the National Health Service Corps Scholarship Program under section 338A(g)(1)(A) of the Public Health Service Act, or

"(B) the Armed Forces Health Professions Scholarship and Financial Assistance program under subchapter I of chapter 105 of title 10, United States Code.".

(b) EFFECTIVE DATE.—The amendments made by subsection (a) shall apply to amounts received in taxable years beginning after December 31, 2001.

Subtitle C—Liberalization of Tax-Exempt Financing Rules for Public School Construction

SEC. 421. ADDITIONAL INCREASE IN ARBITRAGE REBATE EXCEPTION FOR GOVERNMENTAL BONDS USED TO FINANCE EDUCATIONAL FACILITIES.

(a) IN GENERAL.—Section 148(f)(4)(D)(vii) (relating to increase in exception for bonds financing public school capital expenditures) is amended by striking "$5,000,000" the second place it appears and inserting "$10,000,000".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to obligations issued in calendar years beginning after December 31, 2001.

SEC. 422. TREATMENT OF QUALIFIED PUBLIC EDUCATIONAL FACILITY BONDS AS EXEMPT FACILITY BONDS.

(a) TREATMENT AS EXEMPT FACILITY BOND.—Subsection (a) of section 142 (relating to exempt facility bond) is amended by striking "or" at the end of paragraph (11), by striking the period at the end of paragraph (12) and inserting ", or", and by adding at the end the following new paragraph:

"(13) qualified public educational facilities.".

(b) QUALIFIED PUBLIC EDUCATIONAL FACILITIES.—Section 142 (relating to exempt facility bond) is amended by adding at the end the following new subsection:

"(k) QUALIFIED PUBLIC EDUCATIONAL FACILITIES.—

"(1) IN GENERAL.—For purposes of subsection (a)(13), the term 'qualified public educational facility' means any school facility which is—

"(A) part of a public elementary school or a public secondary school, and

"(B) owned by a private, for-profit corporation pursuant to a public-private partnership agreement with a State or local educational agency described in paragraph (2).

"(2) PUBLIC-PRIVATE PARTNERSHIP AGREEMENT DESCRIBED.—A public-private partnership agreement is described in this paragraph if it is an agreement—

"(A) under which the corporation agrees—

"(i) to do 1 or more of the following: construct, rehabilitate, refurbish, or equip a school facility, and

"(ii) at the end of the term of the agreement, to transfer the school facility to such agency for no additional consideration, and

"(B) the term of which does not exceed the term of the issue to be used to provide the school facility.

"(3) SCHOOL FACILITY.—For purposes of this subsection, the term 'school facility' means—

"(A) any school building,

"(B) any functionally related and subordinate facility and land with respect to such building, including any stadium or other facility primarily used for school events, and

"(C) any property, to which section 168 applies (or would apply but for section 179), for use in a facility described in subparagraph (A) or (B).

"(4) PUBLIC SCHOOLS.—For purposes of this subsection, the terms 'elementary school' and 'secondary school' have the meanings given such terms by section 14101 of the Elementary and Secondary Education Act of 1965 (20 U.S.C. 8801), as in effect on the date of the enactment of this subsection.

"(5) ANNUAL AGGREGATE FACE AMOUNT OF TAX-EXEMPT FINANCING.—

"(A) IN GENERAL.—An issue shall not be treated as an issue described in subsection (a)(13) if the aggregate face amount of bonds issued by the State pursuant thereto (when added to the aggregate face amount of bonds previously so issued during the calendar year) exceeds an amount equal to the greater of—

"(i) $10 multiplied by the State population, or

"(ii) $5,000,000.

"(B) ALLOCATION RULES.—

"(i) IN GENERAL.—Except as otherwise provided in this subparagraph, the State may allocate the amount described in subparagraph (A) for any calendar year in such manner as the State determines appropriate.

"(ii) RULES FOR CARRYFORWARD OF UNUSED LIMITATION.—A State may elect to carry forward an unused limitation for any calendar year for 3 calendar years following the calendar year in which the unused limitation arose under rules similar to the rules of section 146(f), except that the only purpose for which the carryforward may be elected is the issuance of exempt facility bonds described in subsection (a)(13).".

(c) EXEMPTION FROM GENERAL STATE VOLUME CAPS.—Paragraph (3) of section 146(g) (relating to exception for certain bonds) is amended—

(1) by striking "or (12)" and inserting "(12), or (13)", and

(2) by striking "and environmental enhancements of hydroelectric generating facilities" and inserting "environmental enhancements of hydroelectric generating facilities, and qualified public educational facilities".

(d) EXEMPTION FROM LIMITATION ON USE FOR LAND ACQUISITION.—Section 147(h) (relating to certain rules not to apply to mortgage revenue bonds, qualified student loan bonds, and qualified 501(c)(3) bonds) is amended by adding at the end the following new paragraph:

"(3) EXEMPT FACILITY BONDS FOR QUALIFIED PUBLIC-PRIVATE SCHOOLS.—Subsection (c) shall not apply to any exempt facility bond issued as part of an issue described in section 142(a)(13) (relating to qualified public educational facilities).".

(e) CONFORMING AMENDMENT.—The heading for section 147(h) is amended by striking "MORTGAGE REVENUE BONDS, QUALIFIED STUDENT LOAN BONDS, AND QUALIFIED 501(c)(3) BONDS" and inserting "CERTAIN BONDS".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to bonds issued after December 31, 2001.

Subtitle D—Other Provisions

SEC. 431. DEDUCTION FOR HIGHER EDUCATION EXPENSES.

(a) DEDUCTION ALLOWED.—Part VII of subchapter B of chapter 1 (relating to additional itemized deductions for individuals) is amended by redesignating section 222 as section 223 and by inserting after section 221 the following:

"SEC. 222. QUALIFIED TUITION AND RELATED EXPENSES.

"(a) ALLOWANCE OF DEDUCTION.—In the case of an individual, there shall be allowed as a deduction an amount equal to the qualified tuition and related expenses paid by the taxpayer during the taxable year.

"(b) DOLLAR LIMITATIONS.—

"(1) IN GENERAL.—The amount allowed as a deduction under subsection (a) with respect to the taxpayer for any taxable year shall not exceed the applicable dollar limit.

"(2) APPLICABLE DOLLAR LIMIT.—

"(A) 2002 AND 2003.—In the case of a taxable year beginning in 2002 or 2003, the applicable dollar limit shall be equal to—

"(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $3,000, and—

"(ii) in the case of any other taxpayer, zero.

"(B) 2004 AND 2005.—In the case of a taxable year beginning in 2004 or 2005, the applicable dollar amount shall be equal to—

"(i) in the case of a taxpayer whose adjusted gross income for the taxable year does not exceed $65,000 ($130,000 in the case of a joint return), $4,000,

"(ii) in the case of a taxpayer not described in clause (i) whose adjusted gross income for the taxable year does not exceed $80,000 ($160,000 in the case of a joint return), $2,000, and

"(iii) in the case of any other taxpayer, zero.

"(C) ADJUSTED GROSS INCOME.—For purposes of this paragraph, adjusted gross income shall be determined—

"(i) without regard to this section and sections 911, 931, and 933, and

"(ii) after application of sections 86, 135, 137, 219, 221, and 469.

"(c) NO DOUBLE BENEFIT.—

"(1) IN GENERAL.—No deduction shall be allowed under subsection (a) for any expense for which a deduction is allowed to the taxpayer under any other provision of this chapter.

"(2) COORDINATION WITH OTHER EDUCATION INCENTIVES.—

"(A) DENIAL OF DEDUCTION IF CREDIT ELECTED.—No deduction shall be allowed under subsection (a) for a taxable year with respect to the qualified tuition and related expenses with respect to an individual if the taxpayer or any other person elects to have section 25A apply with respect to such individual for such year.

"(B) COORDINATION WITH EXCLUSIONS.—The total amount of qualified tuition and related expenses shall be reduced by the amount of such expenses taken into account in determining any amount excluded under section 135, 529(c)(1), or 530(d)(2). For purposes of the preceding sentence, the amount taken into account in determining the amount excluded under section 529(c)(1) shall not include that portion of the distribution which represents a return of any contributions to the plan.

"(3) DEPENDENTS.—No deduction shall be allowed under subsection (a) to any individual with respect to whom a deduction under section 151 is allowable to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins.

"(d) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) QUALIFIED TUITION AND RELATED EXPENSES.—The term 'qualified tuition and related expenses' has the meaning given such term by section 25A(f). Such expenses shall be reduced in the same manner as under section 25A(g)(2).

"(2) IDENTIFICATION REQUIREMENT.—No deduction shall be allowed under subsection (a) to a taxpayer with respect to the qualified tuition and related expenses of an individual unless the taxpayer includes the name and taxpayer identification number of the individual on the return of tax for the taxable year.

"(3) LIMITATION ON TAXABLE YEAR OF DEDUCTION.—

"(A) IN GENERAL.—A deduction shall be allowed under subsection (a) for qualified tuition and related expenses for any taxable year only to the extent such expenses are in connection with enrollment at an institution of higher education during the taxable year.

"(B) CERTAIN PREPAYMENTS ALLOWED.—Subparagraph (A) shall not apply to qualified tuition and related expenses paid during a taxable year if such expenses are in connection with an academic term beginning during such taxable year or during the first 3 months of the next taxable year.

"(4) NO DEDUCTION FOR MARRIED INDIVIDUALS FILING SEPARATE RETURNS.—If the taxpayer is a married individual (within the meaning of section 7703), this section shall apply only if the taxpayer and the taxpayer's spouse file a joint return for the taxable year.

"(5) NONRESIDENT ALIENS.—If the taxpayer is a nonresident alien individual for any portion of the taxable year, this section shall apply only if such individual is treated as a resident alien of the United States for purposes of this chapter by reason of an election under subsection (g) or (h) of section 6013.

"(6) REGULATIONS.—The Secretary may prescribe such regulations as may be necessary or appropriate to carry out this section, including regulations requiring recordkeeping and information reporting.

"(e) TERMINATION.—This section shall not apply to taxable years beginning after December 31, 2005.".

(b) DEDUCTION ALLOWED IN COMPUTING ADJUSTED GROSS INCOME.—Section 62(a) is amended by inserting after paragraph (17) the following:

"(18) HIGHER EDUCATION EXPENSES.—The deduction allowed by section 222.".

(c) CONFORMING AMENDMENTS.—

(1) Sections 86(b)(2), 135(c)(4), 137(b)(3), and 219(g)(3) are each amended by inserting "222," after "221,".

(2) Section 221(b)(2)(C) is amended by inserting "222," before "911".

(3) Section 469(i)(3)(F) is amended by striking "and 221" and inserting ", 221, and 222".

(4) The table of sections for part VII of subchapter B of chapter 1 is amended by striking the item relating to section 222 and inserting the following:

"Sec. 222. Qualified tuition and related expenses.
"Sec. 223. Cross reference.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to payments made in taxable years beginning after December 31, 2001.

TITLE V—ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS

Subtitle A—Repeal of Estate and Generation-Skipping Transfer Taxes

SEC. 501. REPEAL OF ESTATE AND GENERATION-SKIPPING TRANSFER TAXES.

(a) ESTATE TAX REPEAL.—Subchapter C of chapter 11 of subtitle B (relating to miscellaneous) is amended by adding at the end the following new section:

"SEC. 2210. TERMINATION.

"(a) IN GENERAL.—Except as provided in subsection (b), this chapter shall not apply to the estates of decedents dying after December 31, 2009.

"(b) CERTAIN DISTRIBUTIONS FROM QUALIFIED DOMESTIC TRUSTS.—In applying section 2056A with respect to the surviving spouse of a decedent dying before January 1, 2010—

"(1) section 2056A(b)(1)(A) shall not apply to distributions made after December 31, 2020, and

"(2) section 2056A(b)(1)(B) shall not apply after December 31, 2009.".

(b) GENERATION-SKIPPING TRANSFER TAX REPEAL.—Subchapter G of chapter 13 of subtitle B (relating to administration) is amended by adding at the end the following new section:

"SEC. 2664. TERMINATION.

"This chapter shall not apply to generation-skipping transfers after December 31, 2009.".

(c) CONFORMING AMENDMENTS.—

(1) The table of sections for subchapter C of chapter 11 is amended by adding at the end the following new item:

"Sec. 2210. Termination.".

(2) The table of sections for subchapter G of chapter 13 is amended by adding at the end the following new item:

"Sec. 2664. Termination.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to the estates of decedents dying, and generation-skipping transfers, after December 31, 2009.

Subtitle B—Reductions of Estate and Gift Tax Rates

SEC. 511. ADDITIONAL REDUCTIONS OF ESTATE AND GIFT TAX RATES.

(a) MAXIMUM RATE OF TAX REDUCED TO 50 PERCENT.—The table contained in section 2001(c)(1) is amended by striking the two highest brackets and inserting the following:

"Over $2,500,000	*$1,025,800, plus 50% of the excess over $2,500,000.".*

(b) REPEAL OF PHASEOUT OF GRADUATED RATES.—Subsection (c) of section 2001 is amended by striking paragraph (2).

(c) ADDITIONAL REDUCTIONS OF MAXIMUM RATE OF TAX.—Subsection (c) of section 2001, as amended by subsection (b), is amended by adding at the end the following new paragraph:

"(2) PHASEDOWN OF MAXIMUM RATE OF TAX.—

"(A) IN GENERAL.—In the case of estates of decedents dying, and gifts made, in calendar years after 2002 and before 2010, the tentative tax under this subsection shall be determined by using a table prescribed by the Secretary (in lieu of using the table contained in paragraph (1)) which is the same as such table; except that—

"(i) the maximum rate of tax for any calendar year shall be determined in the table under subparagraph (B), and

"(ii) the brackets and the amounts setting forth the tax shall be adjusted to the extent necessary to reflect the adjustments under subparagraph (A).

"(B) MAXIMUM RATE.—

"In calendar year:	***The maximum rate is:***
2003	*49 percent*
2004	*48 percent*
2005	*47 percent*
2006	*46 percent*
2007, 2008, and 2009	*45 percent.".*

(d) MAXIMUM GIFT TAX RATE REDUCED TO MAXIMUM INDIVIDUAL RATE AFTER 2009.—Subsection (a) of section 2502 (relating to rate of tax) is amended to read as follows:

"(a) COMPUTATION OF TAX.—

"(1) IN GENERAL.—The tax imposed by section 2501 for each calendar year shall be an amount equal to the excess of—

"(A) a tentative tax, computed under paragraph (2), on the aggregate sum of the taxable gifts for such calendar year and for each of the preceding calendar periods, over

"(B) a tentative tax, computed under paragraph (2), on the aggregate sum of the taxable gifts for each of the preceding calendar periods.

"(2) RATE SCHEDULE.—

"If the amount with respect to which the tentative tax to be computed is:	***The tentative tax is:***
Not over $10,000	*18% of such amount.*
Over $10,000 but not over $20,000	*$1,800, plus 20% of the excess over $10,000.*
Over $20,000 but not over $40,000	*$3,800, plus 22% of the excess over $20,000.*
Over $40,000 but not over $60,000	*$8,200, plus 24% of the excess over $40,000.*
Over $60,000 but not over $80,000	*$13,000, plus 26% of the excess over $60,000.*
Over $80,000 but not over $100,000	*$18,200, plus 28% of the excess over $80,000.*
Over $100,000 but not over $150,000	*$23,800, plus 30% of the excess over $100,000.*
Over $150,000 but not over $250,000	*$38,800, plus 32% of the excess over $150,000.*
Over $250,000 but not over $500,000	*$70,800, plus 34% of the excess over $250,000.*
Over $500,000	*$155,800, plus 35% of the excess over $500,000.".*

(e) TREATMENT OF CERTAIN TRANSFERS IN TRUST.—Section 2511 (relating to transfers in general) is amended by adding at the end the following new subsection:

"(c) TREATMENT OF CERTAIN TRANSFERS IN TRUST.—Notwithstanding any other provision of this section and except as provided in regulations, a transfer in trust shall be treated as a taxable gift under section 2503, unless the trust is treated as wholly owned by the donor or the donor's spouse under subpart E of part I of subchapter J of chapter 1.".

(f) EFFECTIVE DATES.—

(1) SUBSECTIONS (a) AND (b).—The amendments made by subsections (a) and (b) shall apply to estates of decedents dying, and gifts made, after December 31, 2001.

(2) SUBSECTION (c).—The amendment made by subsection (c) shall apply to estates of decedents dying, and gifts made, after December 31, 2002.

(3) SUBSECTIONS (d) AND (e).—The amendments made by subsections (d) and (e) shall apply to gifts made after December 31, 2009.

Subtitle C—Increase in Exemption Amounts

SEC. 521. INCREASE IN EXEMPTION EQUIVALENT OF UNIFIED CREDIT, LIFETIME GIFTS EXEMPTION, AND GST EXEMPTION AMOUNTS.

(a) IN GENERAL.—Subsection (c) of section 2010 (relating to applicable credit amount) is amended by striking the table and inserting the following new table:

"In the case of estates of decedents dying during:	***The applicable exclusion amount is:***
2002 and 2003	*$1,000,000*
2004 and 2005	*$1,500,000*
2006, 2007, and 2008	*$2,000,000*
2009	*$3,500,000.".*

(b) LIFETIME GIFT EXEMPTION INCREASED TO $1,000,000.—

(1) FOR PERIODS BEFORE ESTATE TAX REPEAL.—Paragraph (1) of section 2505(a) (relating to unified credit against gift tax) is amended by inserting "(determined as if the applicable exclusion amount were $1,000,000)" after "calendar year".

(2) FOR PERIODS AFTER ESTATE TAX REPEAL.—Paragraph (1) of section 2505(a) (relating to unified credit against gift tax), as amended by paragraph (1), is amended to read as follows:

"(1) the amount of the tentative tax which would be determined under the rate schedule set forth in section 2502(a)(2) if the amount with respect to which such tentative tax is to be computed were $1,000,000, reduced by".

(c) GST EXEMPTION.—

(1) IN GENERAL.—Subsection (a) of 2631 (relating to GST exemption) is amended by striking "of $1,000,000" and inserting "amount".

(2) EXEMPTION AMOUNT.—Subsection (c) of section 2631 is amended to read as follows:

"(c) GST EXEMPTION AMOUNT.—For purposes of subsection (a), the GST exemption amount for any calendar year shall be equal to the applicable exclusion amount under section 2010(c) for such calendar year.".

(d) REPEAL OF SPECIAL BENEFIT FOR FAMILY-OWNED BUSINESS INTERESTS.—Section 2057 (relating to family-owned business interests) is amended by adding at the end the following new subsection:

"(j) TERMINATION.—This section shall not apply to the estates of decedents dying after December 31, 2003.".

(e) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraphs (2) and (3), the amendments made by this section shall apply to estates of decedents dying, and gifts made, after December 31, 2001.

(2) SUBSECTION (b)(2).—The amendments made by subsection (b)(2) shall apply to gifts made after December 31, 2009.

(3) SUBSECTIONS (c) AND (d).—The amendments made by subsections (c) and (d) shall apply to estates of decedents dying, and generation-skipping transfers, after December 31, 2003.

Subtitle D—Credit for State Death Taxes

SEC. 531. REDUCTION OF CREDIT FOR STATE DEATH TAXES.

(a) IN GENERAL.—Section 2011(b) (relating to amount of credit) is amended—

(1) by striking "CREDIT.—The credit allowed" and inserting "CREDIT.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the credit allowed",

(2) by striking "For purposes" and inserting the following: "(3) ADJUSTED TAXABLE ESTATE.—For purposes", and

(3) by inserting after paragraph (1) the following new paragraph:

"(2) REDUCTION OF MAXIMUM CREDIT.—

"(A) IN GENERAL.—In the case of estates of decedents dying after December 31, 2001, the credit allowed by this section shall not exceed the applicable percentage of the credit otherwise determined under paragraph (1).

"(B) APPLICABLE PERCENTAGE.—

"In the case of estates of decedents dying during:	***The applicable percentage is:***
2002	*75 percent*
2003	*50 percent*
2004	*25 percent.".*

(b) EFFECTIVE DATE.—The amendments made by this subsection shall apply to estates of decedents dying after December 31, 2001.

SEC. 532. CREDIT FOR STATE DEATH TAXES REPLACED WITH DEDUCTION FOR SUCH TAXES.

(a) REPEAL OF CREDIT.—Section 2011 (relating to credit for State death taxes) is amended by adding at the end the following new subsection:

"(g) TERMINATION.—This section shall not apply to the estates of decedents dying after December 31, 2004.".

(b) DEDUCTION FOR STATE DEATH TAXES.—Part IV of subchapter A of chapter 11 is amended by adding at the end the following new section:

"SEC. 2058. STATE DEATH TAXES.

"(a) ALLOWANCE OF DEDUCTION.—For purposes of the tax imposed by section 2001, the value of the taxable estate shall be determined by deducting from the value of the gross estate the amount of any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia, in respect of any property included in the gross estate (not including any such taxes paid with respect to the estate of a person other than the decedent).

"(b) PERIOD OF LIMITATIONS.—The deduction allowed by this section shall include only such taxes as were actually paid and deduction therefor claimed before the later of—

"(1) 4 years after the filing of the return required by section 6018, or

"(2) if—

"(A) a petition for redetermination of a deficiency has been filed with the Tax Court within the time prescribed in section 6213(a), the expiration of 60 days after the decision of the Tax Court becomes final,

"(B) an extension of time has been granted under section 6161 or 6166 for payment of the tax shown on the return, or of a deficiency, the date of the expiration of the period of the extension, or

"(C) a claim for refund or credit of an overpayment of tax imposed by this chapter has been filed within the time prescribed in section 6511, the latest of the expiration of—

"(i) 60 days from the date of mailing by certified mail or registered mail by the Secretary to the taxpayer of a notice of the disallowance of any part of such claim,

"(ii) 60 days after a decision by any court of competent jurisdiction becomes final with respect to a timely suit instituted upon such claim, or

"(iii) 2 years after a notice of the waiver of disallowance is filed under section 6532(a)(3).

Notwithstanding sections 6511 and 6512, refund based on the deduction may be made if the claim for refund is filed within the period provided in the preceding sentence. Any such refund shall be made without interest.".

(c) CONFORMING AMENDMENTS.—

(1) Subsection (a) of section 2012 is amended by striking "the credit for State death taxes provided by section 2011 and".

(2) Subparagraph (A) of section 2013(c)(1) is amended by striking "2011,".

(3) Paragraph (2) of section 2014(b) is amended by striking ", 2011,".

(4) Sections 2015 and 2016 are each amended by striking "2011 or".

(5) Subsection (d) of section 2053 is amended to read as follows:

"(d) CERTAIN FOREIGN DEATH TAXES.—

"(1) IN GENERAL.—Notwithstanding the provisions of subsection (c)(1)(B), for purposes of the tax imposed by section 2001, the value of the taxable estate may be determined, if the executor so elects before the expiration of the period of limitation for assessment provided in section 6501, by deducting from the value of the gross estate the amount (as determined in accordance with regulations prescribed by the Secretary) of any estate, succession, legacy, or inheritance tax imposed by and actually paid to any foreign country, in respect of any property situated within such foreign country and included in the gross estate of a citizen or resident of the United States, upon a transfer by the decedent for public, charitable, or religious uses described in section 2055. The determination under this paragraph of the country within which property is situated shall be made in accordance with the rules applicable under subchapter B (sec. 2101 and following) in determining whether property is situated within or without the United States. Any election under this paragraph shall be exercised in accordance with regulations prescribed by the Secretary.

"(2) CONDITION FOR ALLOWANCE OF DEDUCTION.—No deduction shall be allowed under paragraph (1) for a foreign death tax specified therein unless the decrease in the tax imposed by section 2001 which results from the deduction provided in paragraph (1) will inure solely for the benefit of the public, charitable, or religious transferees described in section 2055 or section 2106(a)(2). In any case where the tax imposed by section 2001 is equitably apportioned among all the trans-

ferees of property included in the gross estate, including those described in sections 2055 and 2106(a)(2) (taking into account any exemptions, credits, or deductions allowed by this chapter), in determining such decrease, there shall be disregarded any decrease in the Federal estate tax which any transferees other than those described in sections 2055 and 2106(a)(2) are required to pay.

"(3) EFFECT ON CREDIT FOR FOREIGN DEATH TAXES OF DEDUCTION UNDER THIS SUBSECTION.—

"(A) ELECTION.—An election under this subsection shall be deemed a waiver of the right to claim a credit, against the Federal estate tax, under a death tax convention with any foreign country for any tax or portion thereof in respect of which a deduction is taken under this subsection.

"(B) CROSS REFERENCE.—

"See section 2014(f) for the effect of a deduction taken under this paragraph on the credit for foreign death taxes.".

(6) Subparagraph (A) of section 2056A(b)(10) is amended—

(A) by striking "2011,", and

(B) by inserting "2058," after "2056,".

(7)(A) Subsection (a) of section 2102 is amended to read as follows:

"(a) IN GENERAL.—The tax imposed by section 2101 shall be credited with the amounts determined in accordance with sections 2012 and 2013 (relating to gift tax and tax on prior transfers).".

(B) Section 2102 is amended by striking subsection (b) and by redesignating subsection (c) as subsection (b).

(C) Section 2102(b)(5) (as redesignated by subparagraph (B)) and section 2107(c)(3) are each amended by striking "2011 to 2013, inclusive," and inserting "2012 and 2013".

(8) Subsection (a) of section 2106 is amended by adding at the end the following new paragraph:

"(4) STATE DEATH TAXES.—The amount which bears the same ratio to the State death taxes as the value of the property, as determined for purposes of this chapter, upon which State death taxes were paid and which is included in the gross estate under section 2103 bears to the value of the total gross estate under section 2103. For purposes of this paragraph, the term 'State death taxes' means the taxes described in section 2011(a).".

(9) Section 2201 is amended—

(A) by striking "as defined in section 2011(d)", and

(B) by adding at the end the following new flush sentence:

"For purposes of this section, the additional estate tax is the difference between the tax imposed by section 2001 or 2101 and the amount equal to 125 percent of the maximum credit provided by section 2011(b), as in effect before its repeal by the Economic Growth and Tax Relief Reconciliation Act of 2001.".

(10) Section 2604 (relating to credit for certain State taxes) is amended by adding at the end the following new subsection:

"(c) TERMINATION.—This section shall not apply to the generation-skipping transfers after December 31, 2004.".

(11) Paragraph (2) of section 6511(i) is amended by striking "2011(c), 2014(b)," and inserting "2014(b)".

(12) Subsection (c) of section 6612 is amended by striking "section 2011(c) (relating to refunds due to credit for State taxes),".

(13) The table of sections for part II of subchapter A of chapter 11 is amended by striking the item relating to section 2011.

(14) The table of sections for part IV of subchapter A of chapter 11 is amended by adding at the end the following new item:

"Sec. 2058. State death taxes.".

(15) The table of sections for subchapter A of chapter 13 is amended by striking the item relating to section 2604.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying, and generation-skipping transfers, after December 31, 2004.

Subtitle E—Carryover Basis at Death; Other Changes Taking Effect With Repeal

SEC. 541. TERMINATION OF STEP-UP IN BASIS AT DEATH.

Section 1014 (relating to basis of property acquired from a decedent) is amended by adding at the end the following new subsection:

"(f) TERMINATION.—This section shall not apply with respect to decedents dying after December 31, 2009.".

SEC. 542. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2009.

(a) GENERAL RULE.—Part II of subchapter O of chapter 1 (relating to basis rules of general application) is amended by inserting after section 1021 the following new section:

"SEC. 1022. TREATMENT OF PROPERTY ACQUIRED FROM A DECEDENT DYING AFTER DECEMBER 31, 2009.

"(a) IN GENERAL.—Except as otherwise provided in this section—

"(1) property acquired from a decedent dying after December 31, 2009, shall be treated for purposes of this subtitle as transferred by gift, and

"(2) the basis of the person acquiring property from such a decedent shall be the lesser of—

"(A) the adjusted basis of the decedent, or

"(B) the fair market value of the property at the date of the decedent's death.

"(b) BASIS INCREASE FOR CERTAIN PROPERTY.—

"(1) IN GENERAL.—In the case of property to which this subsection applies, the basis of such property under subsection (a) shall be increased by its basis increase under this subsection.

"(2) BASIS INCREASE.—For purposes of this subsection—

"(A) IN GENERAL.—The basis increase under this subsection for any property is the portion of the aggregate basis increase which is allocated to the property pursuant to this section.

"(B) AGGREGATE BASIS INCREASE.—In the case of any estate, the aggregate basis increase under this subsection is $1,300,000.

"(C) LIMIT INCREASED BY UNUSED BUILT-IN LOSSES AND LOSS CARRYOVERS.—The limitation under subparagraph (B) shall be increased by—

"(i) the sum of the amount of any capital loss carryover under section 1212(b), and the amount of any net operating loss carryover under section 172, which would (but for the decedent's death) be carried from the decedent's last taxable year to a later taxable year of the decedent, plus

"(ii) the sum of the amount of any losses that would have been allowable under section 165 if the property acquired from the decedent had been sold at fair market value immediately before the decedent's death.

"(3) DECEDENT NONRESIDENTS WHO ARE NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent nonresident not a citizen of the United States—

"(A) paragraph (2)(B) shall be applied by substituting '$60,000' for '$1,300,000', and

"(B) paragraph (2)(C) shall not apply.

"(c) ADDITIONAL BASIS INCREASE FOR PROPERTY ACQUIRED BY SURVIVING SPOUSE.—

"(1) IN GENERAL.—In the case of property to which this subsection applies and which is qualified spousal property, the basis of such property under subsection (a) (as increased under subsection (b)) shall be increased by its spousal property basis increase.

"(2) SPOUSAL PROPERTY BASIS INCREASE.—For purposes of this subsection—

"(A) IN GENERAL.—The spousal property basis increase for property referred to in paragraph (1) is the portion of the aggregate spousal property basis increase which is allocated to the property pursuant to this section.

"(B) AGGREGATE SPOUSAL PROPERTY BASIS INCREASE.—In the case of any estate, the aggregate spousal property basis increase is $3,000,000.

"(3) QUALIFIED SPOUSAL PROPERTY.—For purposes of this subsection, the term 'qualified spousal property' means—

"(A) outright transfer property, and

"(B) qualified terminable interest property.

"(4) OUTRIGHT TRANSFER PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'outright transfer property' means any interest in property acquired from the decedent by the decedent's surviving spouse.

"(B) EXCEPTION.—Subparagraph (A) shall not apply where, on the lapse of time, on the occurrence of an event or contingency, or on the failure of an event or contingency to occur, an interest passing to the surviving spouse will terminate or fail—

"(i)(I) if an interest in such property passes or has passed (for less than an adequate and full consideration in money or money's worth) from the decedent to any person other than such surviving spouse (or the estate of such spouse), and

"(II) if by reason of such passing such person (or his heirs or assigns) may possess or enjoy any part of such property after such termination or failure of the interest so passing to the surviving spouse, or

"(ii) if such interest is to be acquired for the surviving spouse, pursuant to directions of the decedent, by his executor or by the trustee of a trust.

For purposes of this subparagraph, an interest shall not be considered as an interest which will terminate or fail merely because it is the ownership of a bond, note, or similar contractual obligation, the discharge of which would not have the effect of an annuity for life or for a term.

"(C) INTEREST OF SPOUSE CONDITIONAL ON SURVIVAL FOR LIMITED PERIOD.—For purposes of this paragraph, an interest passing to the surviving spouse shall not be considered as an interest which will terminate or fail on the death of such spouse if—

"(i) such death will cause a termination or failure of such interest only if it occurs within a period not exceeding 6 months after the decedent's death, or only if it occurs as a result of a common disaster resulting in the death of the decedent and the surviving spouse, or only if it occurs in the case of either such event, and

"(ii) such termination or failure does not in fact occur.

"(5) QUALIFIED TERMINABLE INTEREST PROPERTY.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified terminable interest property' means property—

"(i) which passes from the decedent, and

"(ii) in which the surviving spouse has a qualifying income interest for life.

"(B) QUALIFYING INCOME INTEREST FOR LIFE.—The surviving spouse has a qualifying income interest for life if—

"(i) the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, or has a usufruct interest for life in the property, and

"(ii) no person has a power to appoint any part of the property to any person other than the surviving spouse.

Clause (ii) shall not apply to a power exercisable only at or after the death of the surviving spouse. To the extent provided in regulations, an annuity shall be treated in a manner similar to an income interest in property (regardless of whether the property from which the annuity is payable can be separately identified).

"(C) PROPERTY INCLUDES INTEREST THEREIN.—The term 'property' includes an interest in property.

"(D) SPECIFIC PORTION TREATED AS SEPARATE PROPERTY.—A specific portion of property shall be treated as separate property. For purposes of the preceding sentence, the term 'specific portion' only includes a portion determined on a fractional or percentage basis.

"(d) DEFINITIONS AND SPECIAL RULES FOR APPLICATION OF SUBSECTIONS (b) AND (c).—

"(1) PROPERTY TO WHICH SUBSECTIONS (b) AND (c) APPLY.—

"(A) IN GENERAL.—The basis of property acquired from a decedent may be increased under subsection (b) or (c) only if the property was owned by the decedent at the time of death.

"(B) RULES RELATING TO OWNERSHIP.—

"(i) JOINTLY HELD PROPERTY.—In the case of property which was owned by the decedent and another person as joint tenants with right of survivorship or tenants by the entirety—

"(I) if the only such other person is the surviving spouse, the decedent shall be treated as the owner of only 50 percent of the property,

"(II) in any case (to which subclause (I) does not apply) in which the decedent furnished consideration for the acquisition of the property, the decedent shall be treated as the owner to the extent of the portion of the property which is proportionate to such consideration, and

"(III) in any case (to which subclause (I) does not apply) in which the property has been acquired by gift, bequest, devise, or inheritance by the decedent and any other person as joint tenants with right of survivorship and their interests are not otherwise specified or fixed by law, the decedent shall be treated as the owner to the extent of the value of a fractional part to be determined by dividing the value of the property by the number of joint tenants with right of survivorship.

"(ii) REVOCABLE TRUSTS.—The decedent shall be treated as owning property transferred by the decedent during life to a qualified revocable trust (as defined in section 645(b)(1)).

"(iii) POWERS OF APPOINTMENT.—The decedent shall not be treated as owning any property by reason of holding a power of appointment with respect to such property.

"(iv) COMMUNITY PROPERTY.—Property which represents the surviving spouse's one-half share of community property held by the decedent and the surviving spouse under the community property laws of any State or possession of the United States or any foreign country shall be treated for purposes of this section as owned by, and acquired from, the decedent if at least one-half of the whole of the community interest in such property is treated as owned by, and acquired from, the decedent without regard to this clause.

"(C) PROPERTY ACQUIRED BY DECEDENT BY GIFT WITHIN 3 YEARS OF DEATH.—

"(i) IN GENERAL.—Subsections (b) and (c) shall not apply to property acquired by the decedent by gift or by inter vivos transfer for less than adequate and full con-

sideration in money or money's worth during the 3-year period ending on the date of the decedent's death.

"(ii) EXCEPTION FOR CERTAIN GIFTS FROM SPOUSE.—Clause (i) shall not apply to property acquired by the decedent from the decedent's spouse unless, during such 3-year period, such spouse acquired the property in whole or in part by gift or by inter vivos transfer for less than adequate and full consideration in money or money's worth.

"(D) STOCK OF CERTAIN ENTITIES.—Subsections (b) and (c) shall not apply to—

"(i) stock or securities of a foreign personal holding company,

"(ii) stock of a DISC or former DISC,

"(iii) stock of a foreign investment company, or

"(iv) stock of a passive foreign investment company unless such company is a qualified electing fund (as defined in section 1295) with respect to the decedent.

"(2) FAIR MARKET VALUE LIMITATION.—The adjustments under subsections (b) and (c) shall not increase the basis of any interest in property acquired from the decedent above its fair market value in the hands of the decedent as of the date of the decedent's death.

"(3) ALLOCATION RULES.—

"(A) IN GENERAL.—The executor shall allocate the adjustments under subsections (b) and (c) on the return required by section 6018.

"(B) CHANGES IN ALLOCATION.—Any allocation made pursuant to subparagraph (A) may be changed only as provided by the Secretary.

"(4) INFLATION ADJUSTMENT OF BASIS ADJUSTMENT AMOUNTS.—

"(A) IN GENERAL.—In the case of decedents dying in a calendar year after 2010, the $1,300,000, $60,000, and $3,000,000 dollar amounts in subsections (b) and (c)(2)(B) shall each be increased by an amount equal to the product of—

"(i) such dollar amount, and

"(ii) the cost-of-living adjustment determined under section 1(f)(3) for such calendar year, determined by substituting '2009' for '1992' in subparagraph (B) thereof.

"(B) ROUNDING.—If any increase determined under subparagraph (A) is not a multiple of—

"(i) $100,000 in the case of the $1,300,000 amount,

"(ii) $5,000 in the case of the $60,000 amount, and

"(iii) $250,000 in the case of the $3,000,000 amount,

such increase shall be rounded to the next lowest multiple thereof.

"(e) PROPERTY ACQUIRED FROM THE DECEDENT.—For purposes of this section, the following property shall be considered to have been acquired from the decedent:

"(1) Property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent.

"(2) Property transferred by the decedent during his lifetime—

"(A) to a qualified revocable trust (as defined in section 645(b)(1)), or

"(B) to any other trust with respect to which the decedent reserved the right to make any change in the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust.

"(3) Any other property passing from the decedent by reason of death to the extent that such property passed without consideration.

"(f) COORDINATION WITH SECTION 691.—This section shall not apply to property which constitutes a right to receive an item of income in respect of a decedent under section 691.

"(g) CERTAIN LIABILITIES DISREGARDED.—

"(1) IN GENERAL.—In determining whether gain is recognized on the acquisition of property—

"(A) from a decedent by a decedent's estate or any beneficiary other than a tax-exempt beneficiary, and

"(B) from the decedent's estate by any beneficiary other than a tax-exempt beneficiary,

and in determining the adjusted basis of such property, liabilities in excess of basis shall be disregarded.

"(2) TAX-EXEMPT BENEFICIARY.—For purposes of paragraph (1), the term 'tax-exempt beneficiary' means—

"(A) the United States, any State or political subdivision thereof, any possession of the United States, any Indian tribal government (within the meaning of section 7871), or any agency or instrumentality of any of the foregoing,

"(B) an organization (other than a cooperative described in section 521) which is exempt from tax imposed by chapter 1,

"(C) any foreign person or entity (within the meaning of section 168(h)(2)), and

"(D) to the extent provided in regulations, any person to whom property is transferred for the principal purpose of tax avoidance.

"(h) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.".

(b) INFORMATION RETURNS, ETC.—

(1) LARGE TRANSFERS AT DEATH.—So much of subpart C of part II of subchapter A of chapter 61 as precedes section 6019 is amended to read as follows:

"Subpart C—Returns Relating to Transfers During Life or at Death

"Sec. 6018. Returns relating to large transfers at death.
"Sec. 6019. Gift tax returns.

"SEC. 6018. RETURNS RELATING TO LARGE TRANSFERS AT DEATH.

"(a) IN GENERAL.—If this section applies to property acquired from a decedent, the executor of the estate of such decedent shall

make a return containing the information specified in subsection (c) with respect to such property.

"(b) PROPERTY TO WHICH SECTION APPLIES.—

"(1) LARGE TRANSFERS.—This section shall apply to all property (other than cash) acquired from a decedent if the fair market value of such property acquired from the decedent exceeds the dollar amount applicable under section 1022(b)(2)(B) (without regard to section 1022(b)(2)(C)).

"(2) TRANSFERS OF CERTAIN GIFTS RECEIVED BY DECEDENT WITHIN 3 YEARS OF DEATH.—This section shall apply to any appreciated property acquired from the decedent if—

"(A) subsections (b) and (c) of section 1022 do not apply to such property by reason of section 1022(d)(1)(C), and

"(B) such property was required to be included on a return required to be filed under section 6019.

"(3) NONRESIDENTS NOT CITIZENS OF THE UNITED STATES.—In the case of a decedent who is a nonresident not a citizen of the United States, paragraphs (1) and (2) shall be applied—

"(A) by taking into account only—

"(i) tangible property situated in the United States, and

"(ii) other property acquired from the decedent by a United States person, and

"(B) by substituting the dollar amount applicable under section 1022(b)(3) for the dollar amount referred to in paragraph (1).

"(4) RETURNS BY TRUSTEES OR BENEFICIARIES.—If the executor is unable to make a complete return as to any property acquired from or passing from the decedent, the executor shall include in the return a description of such property and the name of every person holding a legal or beneficial interest therein. Upon notice from the Secretary, such person shall in like manner make a return as to such property.

"(c) INFORMATION REQUIRED TO BE FURNISHED.—The information specified in this subsection with respect to any property acquired from the decedent is—

"(1) the name and TIN of the recipient of such property,

"(2) an accurate description of such property,

"(3) the adjusted basis of such property in the hands of the decedent and its fair market value at the time of death,

"(4) the decedent's holding period for such property,

"(5) sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

"(6) the amount of basis increase allocated to the property under subsection (b) or (c) of section 1022, and

"(7) such other information as the Secretary may by regulations prescribe.

"(d) PROPERTY ACQUIRED FROM DECEDENT.—For purposes of this section, section 1022 shall apply for purposes of determining the property acquired from a decedent.

"(e) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return (other than the person required to make such return) a written statement showing—

"(1) the name, address, and phone number of the person required to make such return, and

"(2) the information specified in subsection (c) with respect to property acquired from, or passing from, the decedent to the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished not later than 30 days after the date that the return required by subsection (a) is filed.".

(2) GIFTS.—Section 6019 (relating to gift tax returns) is amended—

(A) by striking "Any individual" and inserting "(a) IN GENERAL.—Any individual", and

(B) by adding at the end the following new subsection:

"(b) STATEMENTS TO BE FURNISHED TO CERTAIN PERSONS.—Every person required to make a return under subsection (a) shall furnish to each person whose name is required to be set forth in such return (other than the person required to make such return) a written statement showing—

"(1) the name, address, and phone number of the person required to make such return, and

"(2) the information specified in such return with respect to property received by the person required to receive such statement.

The written statement required under the preceding sentence shall be furnished not later than 30 days after the date that the return required by subsection (a) is filed.".

(3) TIME FOR FILING SECTION 6018 RETURNS.—

(A) RETURNS RELATING TO LARGE TRANSFERS AT DEATH.—Subsection (a) of section 6075 is amended to read as follows:

"(a) RETURNS RELATING TO LARGE TRANSFERS AT DEATH.—The return required by section 6018 with respect to a decedent shall be filed with the return of the tax imposed by chapter 1 for the decedent's last taxable year or such later date specified in regulations prescribed by the Secretary.".

(B) CONFORMING AMENDMENTS.—Paragraph (3) of section 6075(b) is amended—

(i) by striking "ESTATE TAX RETURN" in the heading and inserting "SECTION 6018 RETURN", and

(ii) by striking "(relating to estate tax returns)" and inserting "(relating to returns relating to large transfers at death)".

(4) PENALTIES.—Part I of subchapter B of chapter 68 (relating to assessable penalties) is amended by adding at the end the following new section:

"SEC. 6716. FAILURE TO FILE INFORMATION WITH RESPECT TO CERTAIN TRANSFERS AT DEATH AND GIFTS.

"(a) INFORMATION REQUIRED TO BE FURNISHED TO THE SECRETARY.—Any person required to furnish any information under section 6018 who fails to furnish such information on the date prescribed therefor (determined with regard to any extension of time for filing) shall pay a penalty of $10,000 ($500 in the case of information required to be furnished under section 6018(b)(2)) for each such failure.

"(b) INFORMATION REQUIRED TO BE FURNISHED TO BENEFICIARIES.—Any person required to furnish in writing to each person described in section 6018(e) or 6019(b) the information required under such section who fails to furnish such information shall pay a penalty of $50 for each such failure.

"(c) REASONABLE CAUSE EXCEPTION.—No penalty shall be imposed under subsection (a) or (b) with respect to any failure if it is shown that such failure is due to reasonable cause.

"(d) INTENTIONAL DISREGARD.—If any failure under subsection (a) or (b) is due to intentional disregard of the requirements under sections 6018 and 6019(b), the penalty under such subsection shall be 5 percent of the fair market value (as of the date of death or, in the case of section 6019(b), the date of the gift) of the property with respect to which the information is required.

"(e) DEFICIENCY PROCEDURES NOT TO APPLY.—Subchapter B of chapter 63 (relating to deficiency procedures for income, estate, gift, and certain excise taxes) shall not apply in respect of the assessment or collection of any penalty imposed by this section.".

(5) CLERICAL AMENDMENTS.—

(A) The table of sections for part I of subchapter B of chapter 68 is amended by adding at the end the following new item:

"Sec. 6716. Failure to file information with respect to certain transfers at death and gifts.".

(B) The item relating to subpart C in the table of subparts for part II of subchapter A of chapter 61 is amended to read as follows:

"Subpart C. Returns relating to transfers during life or at death.".

(c) EXCLUSION OF GAIN ON SALE OF PRINCIPAL RESIDENCE MADE AVAILABLE TO HEIR OF DECEDENT IN CERTAIN CASES.—Subsection (d) of section 121 (relating to exclusion of gain from sale of principal residence) is amended by adding at the end the following new paragraph:

"(9) PROPERTY ACQUIRED FROM A DECEDENT.—The exclusion under this section shall apply to property sold by—

"(A) the estate of a decedent,

"(B) any individual who acquired such property from the decedent (within the meaning of section 1022), and

"(C) a trust which, immediately before the death of the decedent, was a qualified revocable trust (as defined in section 645(b)(1)) established by the decedent,

determined by taking into account the ownership and use by the decedent.".

(d) TRANSFERS OF APPRECIATED CARRYOVER BASIS PROPERTY TO SATISFY PECUNIARY BEQUEST.—

(1) IN GENERAL.—Section 1040 (relating to transfer of certain farm, etc., real property) is amended to read as follows:

"SEC. 1040. USE OF APPRECIATED CARRYOVER BASIS PROPERTY TO SATISFY PECUNIARY BEQUEST.

"(a) IN GENERAL.—If the executor of the estate of any decedent satisfies the right of any person to receive a pecuniary bequest with appreciated property, then gain on such exchange shall be recognized to the estate only to the extent that, on the date of such exchange, the fair market value of such property exceeds such value on the date of death.

"(b) SIMILAR RULE FOR CERTAIN TRUSTS.—To the extent provided in regulations prescribed by the Secretary, a rule similar to the rule provided in subsection (a) shall apply where—

"(1) by reason of the death of the decedent, a person has a right to receive from a trust a specific dollar amount which is the equivalent of a pecuniary bequest, and

"(2) the trustee of a trust satisfies such right with property.

"(c) BASIS OF PROPERTY ACQUIRED IN EXCHANGE DESCRIBED IN SUBSECTION (a) OR (b).—The basis of property acquired in an exchange with respect to which gain realized is not recognized by reason of subsection (a) or (b) shall be the basis of such property immediately before the exchange increased by the amount of the gain recognized to the estate or trust on the exchange.".

(2) The item relating to section 1040 in the table of sections for part III of subchapter O of chapter 1 is amended to read as follows:

"Sec. 1040. Use of appreciated carryover basis property to satisfy pecuniary bequest.".

(e) AMENDMENTS RELATED TO CARRYOVER BASIS.—

(1) RECOGNITION OF GAIN ON TRANSFERS TO NONRESIDENTS.—

(A) Subsection (a) of section 684 is amended by inserting "or to a nonresident alien" after "or trust".

(B) Subsection (b) of section 684 is amended to read as follows:

"(b) EXCEPTIONS.—

"(1) TRANSFERS TO CERTAIN TRUSTS.—Subsection (a) shall not apply to a transfer to a trust by a United States person to the extent that any United States person is treated as the owner of such trust under section 671.

"(2) LIFETIME TRANSFERS TO NONRESIDENT ALIENS.—Subsection (a) shall not apply to a lifetime transfer to a nonresident alien.".

*(C) The section heading for section 684 is amended by inserting "**AND NONRESIDENT ALIENS**" after "**ESTATES**".*

(D) The item relating to section 684 in the table of sections for subpart F of part I of subchapter J of chapter 1 is amended by inserting "and nonresident aliens" after "estates".

(2) CAPITAL GAIN TREATMENT FOR INHERITED ART WORK OR SIMILAR PROPERTY.—

(A) IN GENERAL.—Subparagraph (C) of section 1221(a)(3) (defining capital asset) is amended by inserting "(other than by reason of section 1022)" after "is determined".

(B) COORDINATION WITH SECTION 170.—Paragraph (1) of section 170(e) (relating to certain contributions of ordinary income and capital gain property) is amended by adding at the end the following: "For purposes of this paragraph, the determination of whether property is a capital asset shall be made without regard to the exception contained in section 1221(a)(3)(C) for basis determined under section 1022.".

(3) DEFINITION OF EXECUTOR.—Section 7701(a) (relating to definitions) is amended by adding at the end the following:

"(47) EXECUTOR.—The term 'executor' means the executor or administrator of the decedent, or, if there is no executor or administrator appointed, qualified, and acting within the United States, then any person in actual or constructive possession of any property of the decedent.".

(4) CERTAIN TRUSTS.—Subparagraph (A) of section 4947(a)(2) is amended by inserting "642(c)," after "170(f)(2)(B),".

(5) OTHER AMENDMENTS.—

(A) Section 1246 is amended by striking subsection (e).

(B) Subsection (e) of section 1291 is amended—

(i) by striking "(e),"; and

(ii) by striking "; except that" and all that follows and inserting a period.

(C) Section 1296 is amended by striking subsection (i).

(6) CLERICAL AMENDMENT.—The table of sections for part II of subchapter O of chapter 1 is amended by inserting after the item relating to section 1021 the following new item:

"Sec. 1022. Treatment of property acquired from a decedent dying after December 31, 2009.".

(f) EFFECTIVE DATE.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to estates of decedents dying after December 31, 2009.

(2) TRANSFERS TO NONRESIDENTS.—The amendments made by subsection (e)(1) shall apply to transfers after December 31, 2009.

(3) SECTION 4947.—The amendment made by subsection (e)(4) shall apply to deductions for taxable years beginning after December 31, 2009.

Subtitle F—Conservation Easements

SEC. 551. EXPANSION OF ESTATE TAX RULE FOR CONSERVATION EASEMENTS.

(a) REPEAL OF CERTAIN RESTRICTIONS ON WHERE LAND IS LOCATED.—Clause (i) of section 2031(c)(8)(A) (defining land subject to a qualified conservation easement) is amended to read as follows:

"(i) which is located in the United States or any possession of the United States,".

(b) CLARIFICATION OF DATE FOR DETERMINING VALUE OF LAND AND EASEMENT.—Section 2031(c)(2) (defining applicable percentage) is amended by adding at the end the following new sentence: "The values taken into account under the preceding sentence shall be such values as of the date of the contribution referred to in paragraph (8)(B).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2000.

Subtitle G—Modifications of Generation-Skipping Transfer Tax

SEC. 561. DEEMED ALLOCATION OF GST EXEMPTION TO LIFETIME TRANSFERS TO TRUSTS; RETROACTIVE ALLOCATIONS.

(a) IN GENERAL.—Section 2632 (relating to special rules for allocation of GST exemption) is amended by redesignating subsection (c) as subsection (e) and by inserting after subsection (b) the following new subsections:

"(c) DEEMED ALLOCATION TO CERTAIN LIFETIME TRANSFERS TO GST TRUSTS.—

"(1) IN GENERAL.—If any individual makes an indirect skip during such individual's lifetime, any unused portion of such individual's GST exemption shall be allocated to the property transferred to the extent necessary to make the inclusion ratio for such property zero. If the amount of the indirect skip exceeds such unused portion, the entire unused portion shall be allocated to the property transferred.

"(2) UNUSED PORTION.—For purposes of paragraph (1), the unused portion of an individual's GST exemption is that portion of such exemption which has not previously been—

"(A) allocated by such individual,

"(B) treated as allocated under subsection (b) with respect to a direct skip occurring during or before the calendar year in which the indirect skip is made, or

"(C) treated as allocated under paragraph (1) with respect to a prior indirect skip.

"(3) DEFINITIONS.—

"(A) INDIRECT SKIP.—For purposes of this subsection, the term 'indirect skip' means any transfer of property (other than a direct skip) subject to the tax imposed by chapter 12 made to a GST trust.

"(B) GST TRUST.—The term 'GST trust' means a trust that could have a generation-skipping transfer with respect to the transferor unless—

"(i) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons—

"(I) before the date that the individual attains age 46,

"(II) on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or

"(III) upon the occurrence of an event that, in accordance with regulations prescribed by the Secretary, may reasonably be expected to occur before the date that such individual attains age 46,

"(ii) the trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals,

"(iii) the trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in clause (i) or (ii), more than 25 percent of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals,

"(iv) the trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer,

"(v) the trust is a charitable lead annuity trust (within the meaning of section 2642(e)(3)(A)) or a charitable remainder annuity trust or a charitable remainder unitrust (within the meaning of section 664(d)), or

"(vi) the trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

For purposes of this subparagraph, the value of transferred property shall not be considered to be includible in the gross estate of a non-skip person or subject to a right of withdrawal by reason of such person holding a right to withdraw so much of such property as does not exceed the amount referred to in section 2503(b) with respect to any transferor, and it shall be assumed that powers of appointment held by non-skip persons will not be exercised.

"(4) AUTOMATIC ALLOCATIONS TO CERTAIN GST TRUSTS.—For purposes of this subsection, an indirect skip to which section 2642(f) applies shall be deemed to have been made only at the close of the estate tax inclusion period. The fair market value of such transfer shall be the fair market value of the trust property at the close of the estate tax inclusion period.

"(5) APPLICABILITY AND EFFECT.—

"(A) IN GENERAL.—An individual—

"(i) may elect to have this subsection not apply to—

"(I) an indirect skip, or

"(II) any or all transfers made by such individual to a particular trust, and

"(ii) may elect to treat any trust as a GST trust for purposes of this subsection with respect to any or all transfers made by such individual to such trust.

"(B) ELECTIONS.—

"(i) ELECTIONS WITH RESPECT TO INDIRECT SKIPS.—An election under subparagraph (A)(i)(I) shall be deemed to be timely if filed on a timely filed gift tax return for the calendar year in which the transfer was made or deemed to have been made pursuant to paragraph (4) or on such later date or dates as may be prescribed by the Secretary.

"(ii) OTHER ELECTIONS.—An election under clause (i)(II) or (ii) of subparagraph (A) may be made on a timely filed gift tax return for the calendar year for which the election is to become effective.

"(d) RETROACTIVE ALLOCATIONS.—

"(1) IN GENERAL.—If—

"(A) a non-skip person has an interest or a future interest in a trust to which any transfer has been made,

"(B) such person—

"(i) is a lineal descendant of a grandparent of the transferor or of a grandparent of the transferor's spouse or former spouse, and

"(ii) is assigned to a generation below the generation assignment of the transferor, and

"(C) such person predeceases the transferor,

then the transferor may make an allocation of any of such transferor's unused GST exemption to any previous transfer or transfers to the trust on a chronological basis.

"(2) SPECIAL RULES.—If the allocation under paragraph (1) by the transferor is made on a gift tax return filed on or before the date prescribed by section 6075(b) for gifts made within the calendar year within which the non-skip person's death occurred—

"(A) the value of such transfer or transfers for purposes of section 2642(a) shall be determined as if such allocation had been made on a timely filed gift tax return for each calendar year within which each transfer was made,

"(B) such allocation shall be effective immediately before such death, and

"(C) the amount of the transferor's unused GST exemption available to be allocated shall be determined immediately before such death.

"(3) FUTURE INTEREST.—For purposes of this subsection, a person has a future interest in a trust if the trust may permit income or corpus to be paid to such person on a date or dates in the future.".

(b) CONFORMING AMENDMENT.—Paragraph (2) of section 2632(b) is amended by striking "with respect to a prior direct skip" and inserting "or subsection (c)(1)".

(c) EFFECTIVE DATES.—

(1) DEEMED ALLOCATION.—Section 2632(c) of the Internal Revenue Code of 1986 (as added by subsection (a)), and the amendment made by subsection (b), shall apply to transfers subject to chapter 11 or 12 made after December 31, 2000, and to estate tax inclusion periods ending after December 31, 2000.

(2) RETROACTIVE ALLOCATIONS.—Section 2632(d) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to deaths of non-skip persons occurring after December 31, 2000.

SEC. 562. SEVERING OF TRUSTS.

(a) IN GENERAL.—Subsection (a) of section 2642 (relating to inclusion ratio) is amended by adding at the end the following new paragraph:

"(3) SEVERING OF TRUSTS.—

"(A) IN GENERAL.—If a trust is severed in a qualified severance, the trusts resulting from such severance shall be treated as separate trusts thereafter for purposes of this chapter.

"(B) QUALIFIED SEVERANCE.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The term 'qualified severance' means the division of a single trust and the creation (by any means available under the governing instrument or under local law) of two or more trusts if—

"(I) the single trust was divided on a fractional basis, and

"(II) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust.

"(ii) TRUSTS WITH INCLUSION RATIO GREATER THAN ZERO.—If a trust has an inclusion ratio of greater than zero and less than 1, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of 1.

"(iii) REGULATIONS.—The term 'qualified severance' includes any other severance permitted under regulations prescribed by the Secretary.

"(C) TIMING AND MANNER OF SEVERANCES.—A severance pursuant to this paragraph may be made at any time. The Secretary shall prescribe by forms or regulations the manner in which the qualified severance shall be reported to the Secretary.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to severances after December 31, 2000.

SEC. 563. MODIFICATION OF CERTAIN VALUATION RULES.

(a) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—Paragraph (1) of section 2642(b) (relating to valuation rules, etc.) is amended to read as follows:

"(1) GIFTS FOR WHICH GIFT TAX RETURN FILED OR DEEMED ALLOCATION MADE.—If the allocation of the GST exemption to any transfers of property is made on a gift tax return filed on or before the date prescribed by section 6075(b) for such transfer or is deemed to be made under section 2632 (b)(1) or (c)(1)—

"(A) the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 12 (within the meaning of section 2001(f)(2)), or, in the case of an allocation deemed to have been made at the close of an estate tax inclusion period, its value at the time of the close of the estate tax inclusion period, and

"(B) such allocation shall be effective on and after the date of such transfer, or, in the case of an allocation deemed to have been made at the close of an estate tax in-

clusion period, on and after the close of such estate tax inclusion period.".

(b) TRANSFERS AT DEATH.—Subparagraph (A) of section 2642(b)(2) is amended to read as follows:

"(A) TRANSFERS AT DEATH.—If property is transferred as a result of the death of the transferor, the value of such property for purposes of subsection (a) shall be its value as finally determined for purposes of chapter 11; except that, if the requirements prescribed by the Secretary respecting allocation of post-death changes in value are not met, the value of such property shall be determined as of the time of the distribution concerned.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to transfers subject to chapter 11 or 12 of the Internal Revenue Code of 1986 made after December 31, 2000.

SEC. 564. RELIEF PROVISIONS.

(a) IN GENERAL.—Section 2642 is amended by adding at the end the following new subsection:

"(g) RELIEF PROVISIONS.—

"(1) RELIEF FROM LATE ELECTIONS.—

"(A) IN GENERAL.—The Secretary shall by regulation prescribe such circumstances and procedures under which extensions of time will be granted to make—

"(i) an allocation of GST exemption described in paragraph (1) or (2) of subsection (b), and

"(ii) an election under subsection (b)(3) or (c)(5) of section 2632.

Such regulations shall include procedures for requesting comparable relief with respect to transfers made before the date of the enactment of this paragraph.

"(B) BASIS FOR DETERMINATIONS.—In determining whether to grant relief under this paragraph, the Secretary shall take into account all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant. For purposes of determining whether to grant relief under this paragraph, the time for making the allocation (or election) shall be treated as if not expressly prescribed by statute.

"(2) SUBSTANTIAL COMPLIANCE.—An allocation of GST exemption under section 2632 that demonstrates an intent to have the lowest possible inclusion ratio with respect to a transfer or a trust shall be deemed to be an allocation of so much of the transferor's unused GST exemption as produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances shall be taken into account, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Secretary deems relevant.".

(b) EFFECTIVE DATES.—

(1) RELIEF FROM LATE ELECTIONS.—Section 2642(g)(1) of the Internal Revenue Code of 1986 (as added by subsection (a)) shall apply to requests pending on, or filed after, December 31, 2000.

(2) SUBSTANTIAL COMPLIANCE.—Section 2642(g)(2) of such Code (as so added) shall apply to transfers subject to chapter 11 or 12 of the Internal Revenue Code of 1986 made after December 31, 2000. No implication is intended with respect to the availability of relief from late elections or the application of a rule of substantial compliance on or before such date.

Subtitle H—Extension of Time for Payment of Estate Tax

SEC. 571. INCREASE IN NUMBER OF ALLOWABLE PARTNERS AND SHAREHOLDERS IN CLOSELY HELD BUSINESSES.

(a) IN GENERAL.—Paragraphs (1)(B)(ii), (1)(C)(ii), and (9)(B)(iii)(I) of section 6166(b) (relating to definitions and special rules) are each amended by striking "15" and inserting "45".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to estates of decedents dying after December 31, 2001.

SEC. 572. EXPANSION OF AVAILABILITY OF INSTALLMENT PAYMENT FOR ESTATES WITH INTERESTS QUALIFYING LENDING AND FINANCE BUSINESSES.

(a) IN GENERAL.—Section 6166(b) (relating to definitions and special rules) is amended by adding at the end the following new paragraph:

"(10) STOCK IN QUALIFYING LENDING AND FINANCE BUSINESS TREATED AS STOCK IN AN ACTIVE TRADE OR BUSINESS COMPANY.—

"(A) IN GENERAL.—If the executor elects the benefits of this paragraph, then—

"(i) STOCK IN QUALIFYING LENDING AND FINANCE BUSINESS TREATED AS STOCK IN AN ACTIVE TRADE OR BUSINESS COMPANY.—For purposes of this section, any asset used in a qualifying lending and finance business shall be treated as an asset which is used in carrying on a trade or business.

"(ii) 5-YEAR DEFERRAL FOR PRINCIPAL NOT TO APPLY.—The executor shall be treated as having selected under subsection (a)(3) the date prescribed by section 6151(a).

"(iii) 5 EQUAL INSTALLMENTS ALLOWED.—For purposes of applying subsection (a)(1), '5' shall be substituted for '10'.

"(B) DEFINITIONS.—For purposes of this paragraph—

"(i) QUALIFYING LENDING AND FINANCE BUSINESS.—The term 'qualifying lending and finance business' means a lending and finance business, if—

"(I) based on all the facts and circumstances immediately before the date of the decedent's death, there was substantial activity with respect to the lending and finance business, or

"(II) during at least 3 of the 5 taxable years ending before the date of the decedent's death, such business had at least 1 full-time employee substantially all of whose services were the active management of such business, 10 full-time, nonowner employees substantially all of whose services were directly related to such business, and $5,000,000 in

gross receipts from activities described in clause (ii).

"(ii) LENDING AND FINANCE BUSINESS.—The term 'lending and finance business' means a trade or business of—

"(I) making loans,

"(II) purchasing or discounting accounts receivable, notes, or installment obligations,

"(III) engaging in rental and leasing of real and tangible personal property, including entering into leases and purchasing, servicing, and disposing of leases and leased assets,

"(IV) rendering services or making facilities available in the ordinary course of a lending or finance business, and

"(V) rendering services or making facilities available in connection with activities described in subclauses (I) through (IV) carried on by the corporation rendering services or making facilities available, or another corporation which is a member of the same affiliated group (as defined in section 1504 without regard to section 1504(b)(3)).

"(iii) LIMITATION.—The term 'qualifying lending and finance business' shall not include any interest in an entity, if the stock or debt of such entity or a controlled group (as defined in section 267(f)(1)) of which such entity was a member was readily tradable on an established securities market or secondary market (as defined by the Secretary) at any time within 3 years before the date of the decedent's death.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after December 31, 2001.

SEC. 572. CLARIFICATION OF AVAILABILITY OF INSTALLMENT PAYMENT.

(a) IN GENERAL.—Subparagraph (B) of section 6166(b)(8) (relating to all stock must be non-readily-tradable stock) is amended to read as follows:

"(B) ALL STOCK MUST BE NON-READILY-TRADABLE STOCK.—

"(i) IN GENERAL.—No stock shall be taken into account for purposes of applying this paragraph unless it is non-readily-tradable stock (within the meaning of paragraph (7)(B)).

"(ii) SPECIAL APPLICATION WHERE ONLY HOLDING COMPANY STOCK IS NON-READILY-TRADABLE STOCK.—If the requirements of clause (i) are not met, but all of the stock of each holding company taken into account is non-readily-tradable, then this paragraph shall apply, but subsection (a)(1) shall be applied by substituting '5' for '10'.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to estates of decedents dying after December 31, 2001.

Subtitle I—Other Provisions

SEC. 581. WAIVER OF STATUTE OF LIMITATION FOR TAXES ON CERTAIN FARM VALUATIONS.

If on the date of the enactment of this Act (or at any time within 1 year after the date of the enactment) a refund or credit of any overpayment of tax resulting from the application of section 2032A(c)(7)(E) of the Internal Revenue Code of 1986 is barred by any law or rule of law, the refund or credit of such overpayment shall, nevertheless, be made or allowed if claim therefor is filed before the date 1 year after the date of the enactment of this Act.

TITLE VI—PENSION AND INDIVIDUAL RETIREMENT ARRANGEMENT PROVISIONS

Subtitle A—Individual Retirement Accounts

SEC. 601. MODIFICATION OF IRA CONTRIBUTION LIMITS.

(a) INCREASE IN CONTRIBUTION LIMIT.—

(1) IN GENERAL.—Paragraph (1)(A) of section 219(b) (relating to maximum amount of deduction) is amended by striking "$2,000" and inserting "the deductible amount".

(2) DEDUCTIBLE AMOUNT.—Section 219(b) is amended by adding at the end the following new paragraph:

"(5) DEDUCTIBLE AMOUNT.—For purposes of paragraph (1)(A)—

"(A) IN GENERAL.—The deductible amount shall be determined in accordance with the following table:

"For taxable years beginning in:	***The deductible amount is:***
2002 through 2004	*$3,000*
2005 through 2007	*$4,000*
2008 and thereafter	*$5,000.*

"(B) CATCH-UP CONTRIBUTIONS FOR INDIVIDUALS 50 OR OLDER.—

"(i) IN GENERAL.—In the case of an individual who has attained the age of 50 before the close of the taxable year, the deductible amount for such taxable year shall be increased by the applicable amount.

"(ii) APPLICABLE AMOUNT.—For purposes of clause (i), the applicable amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in:	***The applicable amount is:***
2002 through 2005	*$500*
2006 and thereafter	*$1,000.*

"(C) COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—In the case of any taxable year beginning in a calendar year after 2008, the $5,000 amount under subparagraph (A) shall be increased by an amount equal to—

"(I) such dollar amount, multiplied by

"(II) the cost-of-living adjustment determined under section 1(f)(3) for the calendar year in which the taxable year begins, determined by substituting 'calendar year 2007' for 'calendar year 1992' in subparagraph (B) thereof.

"(ii) ROUNDING RULES.—If any amount after adjustment under clause (i) is not a multiple of $500,

such amount shall be rounded to the next lower multiple of $500.".

(b) CONFORMING AMENDMENTS.—

(1) Section 408(a)(1) is amended by striking "in excess of $2,000 on behalf of any individual" and inserting "on behalf of any individual in excess of the amount in effect for such taxable year under section 219(b)(1)(A)".

(2) Section 408(b)(2)(B) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(3) Section 408(b) is amended by striking "$2,000" in the matter following paragraph (4) and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(4) Section 408(j) is amended by striking "$2,000".

(5) Section 408(p)(8) is amended by striking "$2,000" and inserting "the dollar amount in effect under section 219(b)(1)(A)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 602. DEEMED IRAS UNDER EMPLOYER PLANS.

(a) IN GENERAL.—Section 408 (relating to individual retirement accounts) is amended by redesignating subsection (q) as subsection (r) and by inserting after subsection (p) the following new subsection:

"(q) DEEMED IRAS UNDER QUALIFIED EMPLOYER PLANS.—

"(1) GENERAL RULE.—If—

"(A) a qualified employer plan elects to allow employees to make voluntary employee contributions to a separate account or annuity established under the plan, and

"(B) under the terms of the qualified employer plan, such account or annuity meets the applicable requirements of this section or section 408A for an individual retirement account or annuity,

then such account or annuity shall be treated for purposes of this title in the same manner as an individual retirement plan and not as a qualified employer plan (and contributions to such account or annuity as contributions to an individual retirement plan and not to the qualified employer plan). For purposes of subparagraph (B), the requirements of subsection (a)(5) shall not apply.

"(2) SPECIAL RULES FOR QUALIFIED EMPLOYER PLANS.—For purposes of this title, a qualified employer plan shall not fail to meet any requirement of this title solely by reason of establishing and maintaining a program described in paragraph (1).

"(3) DEFINITIONS.—For purposes of this subsection—

"(A) QUALIFIED EMPLOYER PLAN.—The term 'qualified employer plan' has the meaning given such term by section 72(p)(4); except such term shall not include a government plan which is not a qualified plan unless the plan is an eligible deferred compensation plan (as defined in section 457(b)).

"(B) VOLUNTARY EMPLOYEE CONTRIBUTION.—The term 'voluntary employee contribution' means any contribution

(other than a mandatory contribution within the meaning of section 411(c)(2)(C))—

"(i) which is made by an individual as an employee under a qualified employer plan which allows employees to elect to make contributions described in paragraph (1), and

"(ii) with respect to which the individual has designated the contribution as a contribution to which this subsection applies.".

(b) AMENDMENT OF ERISA.—

(1) IN GENERAL.—Section 4 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1003) is amended by adding at the end the following new subsection:

"(c) If a pension plan allows an employee to elect to make voluntary employee contributions to accounts and annuities as provided in section 408(q) of the Internal Revenue Code of 1986, such accounts and annuities (and contributions thereto) shall not be treated as part of such plan (or as a separate pension plan) for purposes of any provision of this title other than section 403(c), 404, or 405 (relating to exclusive benefit, and fiduciary and co-fiduciary responsibilities).".

(2) CONFORMING AMENDMENT.—Section 4(a) of such Act (29 U.S.C. 1003(a)) is amended by inserting "or (c)" after "subsection (b)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2002.

Subtitle B—Expanding Coverage

SEC. 611. INCREASE IN BENEFIT AND CONTRIBUTION LIMITS.

(a) DEFINED BENEFIT PLANS.—

(1) DOLLAR LIMIT.—

(A) Subparagraph (A) of section 415(b)(1) (relating to limitation for defined benefit plans) is amended by striking "$90,000" and inserting "$160,000".

(B) Subparagraphs (C) and (D) of section 415(b)(2) are each amended in the headings and the text, by striking "$90,000" and inserting "$160,000",

(C) Paragraph (7) of section 415(b) (relating to benefits under certain collectively bargained plans) is amended by striking "the greater of $68,212 or one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$90,000'" and inserting "one-half the amount otherwise applicable for such year under paragraph (1)(A) for '$160,000'".

(2) LIMIT REDUCED WHEN BENEFIT BEGINS BEFORE AGE 62.—Subparagraph (C) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 62" and by striking the second sentence.

(3) LIMIT INCREASED WHEN BENEFIT BEGINS AFTER AGE 65.—Subparagraph (D) of section 415(b)(2) is amended by striking "the social security retirement age" each place it appears in the heading and text and inserting "age 65".

(4) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) by striking "$90,000" in paragraph (1)(A) and inserting "$160,000"; and

(B) in paragraph (3)(A)—

(i) by striking "$90,000" in the heading and inserting "$160,000"; and

(ii) by striking "October 1, 1986" and inserting "July 1, 2001".

(5) CONFORMING AMENDMENTS.—

(A) Section 415(b)(2) is amended by striking subparagraph (F).

(B) Section 415(b)(9) is amended to read as follows:

"(9) SPECIAL RULE FOR COMMERCIAL AIRLINE PILOTS.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), in the case of any participant who is a commercial airline pilot, if, as of the time of the participant's retirement, regulations prescribed by the Federal Aviation Administration require an individual to separate from service as a commercial airline pilot after attaining any age occurring on or after age 60 and before age 62, paragraph (2)(C) shall be applied by substituting such age for age 62.

"(B) INDIVIDUALS WHO SEPARATE FROM SERVICE BEFORE AGE 60.—If a participant described in subparagraph (A) separates from service before age 60, the rules of paragraph (2)(C) shall apply.".

(C) Section 415(b)(10)(C)(i) is amended by striking "applied without regard to paragraph (2)(F)".

(b) DEFINED CONTRIBUTION PLANS.—

(1) DOLLAR LIMIT.—Subparagraph (A) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "$30,000" and inserting "$40,000".

(2) COST-OF-LIVING ADJUSTMENTS.—Subsection (d) of section 415 (related to cost-of-living adjustments) is amended—

(A) by striking "$30,000" in paragraph (1)(C) and inserting "$40,000"; and

(B) in paragraph (3)(D)—

(i) by striking "$30,000" in the heading and inserting "$40,000"; and

(ii) by striking "October 1, 1993" and inserting "July 1, 2001".

(c) QUALIFIED TRUSTS.—

(1) COMPENSATION LIMIT.—Sections 401(a)(17), 404(l), 408(k), and 505(b)(7) are each amended by striking "$150,000" each place it appears and inserting "$200,000".

(2) BASE PERIOD AND ROUNDING OF COST-OF-LIVING ADJUSTMENT.—Subparagraph (B) of section 401(a)(17) is amended—

(A) by striking "October 1, 1993" and inserting "July 1, 2001"; and

(B) by striking "$10,000" both places it appears and inserting "$5,000".

(d) ELECTIVE DEFERRALS.—

(1) IN GENERAL.—Paragraph (1) of section 402(g) (relating to limitation on exclusion for elective deferrals) is amended to read as follows:

"(1) IN GENERAL.—

"(A) LIMITATION.—Notwithstanding subsections (e)(3) and (h)(1)(B), the elective deferrals of any individual for any taxable year shall be included in such individual's gross income to the extent the amount of such deferrals for the taxable year exceeds the applicable dollar amount.

"(B) APPLICABLE DOLLAR AMOUNT.—For purposes of subparagraph (A), the applicable dollar amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in calendar year:	***The applicable dollar amount:***
2002	*$11,000*
2003	*$12,000*
2004	*$13,000*
2005	*$14,000*
2006 or thereafter	*$15,000.".*

(2) COST-OF-LIVING ADJUSTMENT.—Paragraph (5) of section 402(g) is amended to read as follows:

"(5) COST-OF-LIVING ADJUSTMENT.—In the case of taxable years beginning after December 31, 2006, the Secretary shall adjust the $15,000 amount under paragraph (1)(B) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Section 402(g) (relating to limitation on exclusion for elective deferrals), as amended by paragraphs (1) and (2), is further amended by striking paragraph (4) and redesignating paragraphs (5), (6), (7), (8), and (9) as paragraphs (4), (5), (6), (7), and (8), respectively.

(B) Paragraph (2) of section 457(c) is amended by striking "402(g)(8)(A)(iii)" and inserting "402(g)(7)(A)(iii)".

(C) Clause (iii) of section 501(c)(18)(D) is amended by striking "(other than paragraph (4) thereof)".

(e) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations) is amended—

(A) in subsections (b)(2)(A) and (c)(1) by striking "$7,500" each place it appears and inserting "the applicable dollar amount"; and

(B) in subsection (b)(3)(A) by striking "$15,000" and inserting "twice the dollar amount in effect under subsection (b)(2)(A)".

(2) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—Paragraph (15) of section 457(e) is amended to read as follows:

"(15) APPLICABLE DOLLAR AMOUNT.—

"(A) IN GENERAL.—The applicable dollar amount shall be the amount determined in accordance with the following table:

"For taxable years beginning in calendar year:	*The applicable dollar amount:*
2002	*$11,000*
2003	*$12,000*
2004	*$13,000*
2005	*$14,000*
2006 or thereafter	*$15,000.*

"(B) COST-OF-LIVING ADJUSTMENTS.—In the case of taxable years beginning after December 31, 2006, the Secretary shall adjust the $15,000 amount under subparagraph (A) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2005, and any increase under this paragraph which is not a multiple of $500 shall be rounded to the next lowest multiple of $500.".

(f) SIMPLE RETIREMENT ACCOUNTS.—

(1) LIMITATION.—Clause (ii) of section 408(p)(2)(A) (relating to general rule for qualified salary reduction arrangement) is amended by striking "$6,000" and inserting "the applicable dollar amount".

(2) APPLICABLE DOLLAR AMOUNT.—Subparagraph (E) of 408(p)(2) is amended to read as follows:

"(E) APPLICABLE DOLLAR AMOUNT; COST-OF-LIVING ADJUSTMENT.—

"(i) IN GENERAL.—For purposes of subparagraph (A)(ii), the applicable dollar amount shall be the amount determined in accordance with the following table:

"For years beginning in calendar year:	*The applicable dollar amount:*
2002	*$7,000*
2003	*$8,000*
2004	*$9,000*
2005 or thereafter	*$10,000.*

"(ii) COST-OF-LIVING ADJUSTMENT.—In the case of a year beginning after December 31, 2005, the Secretary shall adjust the $10,000 amount under clause (i) at the same time and in the same manner as under section 415(d), except that the base period taken into account shall be the calendar quarter beginning July 1, 2004, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.".

(3) CONFORMING AMENDMENTS.—

(A) Subclause (I) of section 401(k)(11)(B)(i) is amended by striking "$6,000" and inserting "the amount in effect under section 408(p)(2)(A)(ii)".

(B) Section 401(k)(11) is amended by striking subparagraph (E).

(g) CERTAIN COMPENSATION LIMITS.—

(1) IN GENERAL.—Subparagraph (A) of section 401(c)(2) (defining earned income) is amended by adding at the end thereof the following new sentence: "For purposes of this part only (other than sections 419 and 419A), this subparagraph shall be applied as if the term 'trade or business' for purposes of section 1402 included service described in section 1402(c)(6).".

(2) SIMPLE RETIREMENT ACCOUNTS.—Clause (ii) of section 408(p)(6)(A) (defining self-employed) is amended by adding at

the end the following new sentence: "The preceding sentence shall be applied as if the term 'trade or business' for purposes of section 1402 included service described in section 1402(c)(6).".

(h) ROUNDING RULE RELATING TO DEFINED BENEFIT PLANS AND DEFINED CONTRIBUTION PLANS.—Paragraph (4) of section 415(d) is amended to read as follows:

"(4) ROUNDING.—

"(A) $160,000 AMOUNT.—Any increase under subparagraph (A) of paragraph (1) which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.

"(B) $40,000 AMOUNT.—Any increase under subparagraph (C) of paragraph (1) which is not a multiple of $1,000 shall be rounded to the next lowest multiple of $1,000.".

(i) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to years beginning after December 31, 2001.

(2) DEFINED BENEFIT PLANS.—The amendments made by subsection (a) shall apply to years ending after December 31, 2001.

SEC. 612. PLAN LOANS FOR SUBCHAPTER S OWNERS, PARTNERS, AND SOLE PROPRIETORS.

(a) IN GENERAL.—Subparagraph (B) of section 4975(f)(6) (relating to exemptions not to apply to certain transactions) is amended by adding at the end the following new clause:

"(iii) LOAN EXCEPTION.—For purposes of subparagraph (A)(i), the term 'owner-employee' shall only include a person described in subclause (II) or (III) of clause (i).".

(b) AMENDMENT OF ERISA.—Section 408(d)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1108(d)(2)) is amended by adding at the end the following new subparagraph:

"(C) For purposes of paragraph (1)(A), the term 'owner-employee' shall only include a person described in clause (ii) or (iii) of subparagraph (A).".

(c) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2001.

SEC. 613. MODIFICATION OF TOP-HEAVY RULES.

(a) SIMPLIFICATION OF DEFINITION OF KEY EMPLOYEE.—

(1) IN GENERAL.—Section 416(i)(1)(A) (defining key employee) is amended—

(A) by striking "or any of the 4 preceding plan years" in the matter preceding clause (i);

(B) by striking clause (i) and inserting the following:

"(i) an officer of the employer having an annual compensation greater than $130,000,";

(C) by striking clause (ii) and redesignating clauses (iii) and (iv) as clauses (ii) and (iii), respectively; and

(D) by striking the second sentence in the matter following clause (iii), as redesignated by subparagraph (C), and by inserting the following: "in the case of plan years beginning after December 31, 2002, the $130,000 amount in

clause (i) shall be adjusted at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning July 1, 2001, and any increase under this sentence which is not a multiple of $5,000 shall be rounded to the next lower multiple of $5,000.".

(2) CONFORMING AMENDMENT.—Section 416(i)(1)(B)(iii) is amended by striking "and subparagraph (A)(ii)".

(b) MATCHING CONTRIBUTIONS TAKEN INTO ACCOUNT FOR MINIMUM CONTRIBUTION REQUIREMENTS.—Section 416(c)(2)(A) (relating to defined contribution plans) is amended by adding at the end the following: "Employer matching contributions (as defined in section 401(m)(4)(A)) shall be taken into account for purposes of this subparagraph (and any reduction under this sentence shall not be taken into account in determining whether section 401(k)(4)(A) applies).".

(c) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

(1) IN GENERAL.—Paragraph (3) of section 416(g) is amended to read as follows:

"(3) DISTRIBUTIONS DURING LAST YEAR BEFORE DETERMINATION DATE TAKEN INTO ACCOUNT.—

"(A) IN GENERAL.—For purposes of determining—

"(i) the present value of the cumulative accrued benefit for any employee, or

"(ii) the amount of the account of any employee,

such present value or amount shall be increased by the aggregate distributions made with respect to such employee under the plan during the 1-year period ending on the determination date. The preceding sentence shall also apply to distributions under a terminated plan which if it had not been terminated would have been required to be included in an aggregation group.

"(B) 5-YEAR PERIOD IN CASE OF IN-SERVICE DISTRIBUTION.—In the case of any distribution made for a reason other than separation from service, death, or disability, subparagraph (A) shall be applied by substituting '5-year period' for '1-year period'.".

(2) BENEFITS NOT TAKEN INTO ACCOUNT.—Subparagraph (E) of section 416(g)(4) is amended—

(A) by striking "LAST 5 YEARS" in the heading and inserting "LAST YEAR BEFORE DETERMINATION DATE"; and

(B) by striking "5-year period" and inserting "1-year period".

(d) DEFINITION OF TOP-HEAVY PLANS.—Paragraph (4) of section 416(g) (relating to other special rules for top-heavy plans) is amended by adding at the end the following new subparagraph:

"(H) CASH OR DEFERRED ARRANGEMENTS USING ALTERNATIVE METHODS OF MEETING NONDISCRIMINATION REQUIREMENTS.—The term 'top-heavy plan' shall not include a plan which consists solely of—

"(i) a cash or deferred arrangement which meets the requirements of section 401(k)(12), and

"(ii) matching contributions with respect to which the requirements of section 401(m)(11) are met.

If, but for this subparagraph, a plan would be treated as a top-heavy plan because it is a member of an aggregation group which is a top-heavy group, contributions under the plan may be taken into account in determining whether any other plan in the group meets the requirements of subsection (c)(2).".

(e) FROZEN PLAN EXEMPT FROM MINIMUM BENEFIT REQUIREMENT.—Subparagraph (C) of section 416(c)(1) (relating to defined benefit plans) is amended—

(A) by striking "clause (ii)" in clause (i) and inserting "clause (ii) or (iii)"; and

(B) by adding at the end the following:

"(iii) EXCEPTION FOR FROZEN PLAN.—For purposes of determining an employee's years of service with the employer, any service with the employer shall be disregarded to the extent that such service occurs during a plan year when the plan benefits (within the meaning of section 410(b)) no key employee or former key employee.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2001.

SEC. 614. ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.

(a) IN GENERAL.—Section 404 (relating to deduction for contributions of an employer to an employees' trust or annuity plan and compensation under a deferred payment plan) is amended by adding at the end the following new subsection:

"(n) ELECTIVE DEFERRALS NOT TAKEN INTO ACCOUNT FOR PURPOSES OF DEDUCTION LIMITS.—Elective deferrals (as defined in section 402(g)(3)) shall not be subject to any limitation contained in paragraph (3), (7), or (9) of subsection (a), and such elective deferrals shall not be taken into account in applying any such limitation to any other contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2001.

SEC. 615. REPEAL OF COORDINATION REQUIREMENTS FOR DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.

(a) IN GENERAL.—Subsection (c) of section 457 (relating to deferred compensation plans of State and local governments and tax-exempt organizations), as amended by section 611, is amended to read as follows:

"(c) LIMITATION.—The maximum amount of the compensation of any one individual which may be deferred under subsection (a) during any taxable year shall not exceed the amount in effect under subsection (b)(2)(A) (as modified by any adjustment provided under subsection (b)(3)).".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to years beginning after December 31, 2001.

SEC. 616. DEDUCTION LIMITS.

(a) MODIFICATION OF LIMITS.—

(1) STOCK BONUS AND PROFIT SHARING TRUSTS.—

(A) IN GENERAL.—Subclause (I) of section 404(a)(3)(A)(i) (relating to stock bonus and profit sharing

trusts) is amended by striking "15 percent" and inserting "25 percent".

(B) CONFORMING AMENDMENT.—Subparagraph (C) of section 404(h)(1) is amended by striking "15 percent" each place it appears and inserting "25 percent".

(2) DEFINED CONTRIBUTION PLANS.—

(A) IN GENERAL.—Clause (v) of section 404(a)(3)(A) (relating to stock bonus and profit sharing trusts) is amended to read as follows:

"(v) DEFINED CONTRIBUTION PLANS SUBJECT TO THE FUNDING STANDARDS.—Except as provided by the Secretary, a defined contribution plan which is subject to the funding standards of section 412 shall be treated in the same manner as a stock bonus or profit-sharing plan for purposes of this subparagraph."

(B) CONFORMING AMENDMENTS.—

(i) Section 404(a)(1)(A) is amended by inserting "(other than a trust to which paragraph (3) applies)" after "pension trust".

(ii) Section 404(h)(2) is amended by striking "stock bonus or profit-sharing trust" and inserting "trust subject to subsection (a)(3)(A)".

(iii) The heading of section 404(h)(2) is amended by striking "STOCK BONUS AND PROFIT-SHARING TRUST" and inserting "CERTAIN TRUSTS".

(b) COMPENSATION.—

(1) IN GENERAL.—Section 404(a) (relating to general rule) is amended by adding at the end the following:

"(12) DEFINITION OF COMPENSATION.—For purposes of paragraphs (3), (7), (8), and (9), the term 'compensation' shall include amounts treated as 'participant's compensation' under subparagraph (C) or (D) of section 415(c)(3).".

(2) CONFORMING AMENDMENTS.—

(A) Subparagraph (B) of section 404(a)(3) is amended by striking the last sentence thereof.

(B) Clause (i) of section 4972(c)(6)(B) is amended by striking "(within the meaning of section 404(a))" and inserting "(within the meaning of section 404(a) and as adjusted under section 404(a)(12))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2001.

SEC. 617. OPTION TO TREAT ELECTIVE DEFERRALS AS AFTER-TAX ROTH CONTRIBUTIONS.

(a) IN GENERAL.—Subpart A of part I of subchapter D of chapter 1 (relating to deferred compensation, etc.) is amended by inserting after section 402 the following new section:

"SEC. 402A. OPTIONAL TREATMENT OF ELECTIVE DEFERRALS AS ROTH CONTRIBUTIONS.

"(a) GENERAL RULE.—If an applicable retirement plan includes a qualified Roth contribution program—

"(1) any designated Roth contribution made by an employee pursuant to the program shall be treated as an elective deferral for purposes of this chapter, except that such contribution shall not be excludable from gross income, and

"(2) such plan (and any arrangement which is part of such plan) shall not be treated as failing to meet any requirement of this chapter solely by reason of including such program.

"(b) QUALIFIED ROTH CONTRIBUTION PROGRAM.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified Roth contribution program' means a program under which an employee may elect to make designated Roth contributions in lieu of all or a portion of elective deferrals the employee is otherwise eligible to make under the applicable retirement plan.

"(2) SEPARATE ACCOUNTING REQUIRED.—A program shall not be treated as a qualified Roth contribution program unless the applicable retirement plan—

"(A) establishes separate accounts ('designated Roth accounts') for the designated Roth contributions of each employee and any earnings properly allocable to the contributions, and

"(B) maintains separate recordkeeping with respect to each account.

"(c) DEFINITIONS AND RULES RELATING TO DESIGNATED ROTH CONTRIBUTIONS.—For purposes of this section—

"(1) DESIGNATED ROTH CONTRIBUTION.—The term 'designated Roth contribution' means any elective deferral which—

"(A) is excludable from gross income of an employee without regard to this section, and

"(B) the employee designates (at such time and in such manner as the Secretary may prescribe) as not being so excludable.

"(2) DESIGNATION LIMITS.—The amount of elective deferrals which an employee may designate under paragraph (1) shall not exceed the excess (if any) of—

"(A) the maximum amount of elective deferrals excludable from gross income of the employee for the taxable year (without regard to this section), over

"(B) the aggregate amount of elective deferrals of the employee for the taxable year which the employee does not designate under paragraph (1).

"(3) ROLLOVER CONTRIBUTIONS.—

"(A) IN GENERAL.—A rollover contribution of any payment or distribution from a designated Roth account which is otherwise allowable under this chapter may be made only if the contribution is to—

"(i) another designated Roth account of the individual from whose account the payment or distribution was made, or

"(ii) a Roth IRA of such individual.

"(B) COORDINATION WITH LIMIT.—Any rollover contribution to a designated Roth account under subparagraph (A) shall not be taken into account for purposes of paragraph (1).

"(d) DISTRIBUTION RULES.—For purposes of this title—

"(1) EXCLUSION.—Any qualified distribution from a designated Roth account shall not be includible in gross income.

"(2) QUALIFIED DISTRIBUTION.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'qualified distribution' has the meaning given such term by section 408A(d)(2)(A) (without regard to clause (iv) thereof).

"(B) DISTRIBUTIONS WITHIN NONEXCLUSION PERIOD.—A payment or distribution from a designated Roth account shall not be treated as a qualified distribution if such payment or distribution is made within the 5-taxable-year period beginning with the earlier of—

"(i) the first taxable year for which the individual made a designated Roth contribution to any designated Roth account established for such individual under the same applicable retirement plan, or

"(ii) if a rollover contribution was made to such designated Roth account from a designated Roth account previously established for such individual under another applicable retirement plan, the first taxable year for which the individual made a designated Roth contribution to such previously established account.

"(C) DISTRIBUTIONS OF EXCESS DEFERRALS AND CONTRIBUTIONS AND EARNINGS THEREON.—The term 'qualified distribution' shall not include any distribution of any excess deferral under section 402(g)(2) or any excess contribution under section 401(k)(8), and any income on the excess deferral or contribution.

"(3) TREATMENT OF DISTRIBUTIONS OF CERTAIN EXCESS DEFERRALS.—Notwithstanding section 72, if any excess deferral under section 402(g)(2) attributable to a designated Roth contribution is not distributed on or before the 1st April 15 following the close of the taxable year in which such excess deferral is made, the amount of such excess deferral shall—

"(A) not be treated as investment in the contract, and

"(B) be included in gross income for the taxable year in which such excess is distributed.

"(4) AGGREGATION RULES.—Section 72 shall be applied separately with respect to distributions and payments from a designated Roth account and other distributions and payments from the plan.

"(e) OTHER DEFINITIONS.—For purposes of this section—

"(1) APPLICABLE RETIREMENT PLAN.—The term 'applicable retirement plan' means—

"(A) an employees' trust described in section 401(a) which is exempt from tax under section 501(a), and

"(B) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b).

"(2) ELECTIVE DEFERRAL.—The term 'elective deferral' means any elective deferral described in subparagraph (A) or (C) of section 402(g)(3).".

(b) EXCESS DEFERRALS.—Section 402(g) (relating to limitation on exclusion for elective deferrals) is amended—

(1) by adding at the end of paragraph (1)(A) (as added by section 201(c)(1)) the following new sentence: "The preceding sentence shall not apply the portion of such excess as does not exceed the designated Roth contributions of the individual for the taxable year."; and

(2) by inserting "(or would be included but for the last sentence thereof)" after "paragraph (1)" in paragraph (2)(A).

(c) ROLLOVERS.—Subparagraph (B) of section 402(c)(8) is amended by adding at the end the following:

"If any portion of an eligible rollover distribution is attributable to payments or distributions from a designated Roth account (as defined in section 402A), an eligible retirement plan with respect to such portion shall include only another designated Roth account and a Roth IRA.".

(d) REPORTING REQUIREMENTS.—

(1) W–2 INFORMATION.—Section 6051(a)(8) is amended by inserting ", including the amount of designated Roth contributions (as defined in section 402A)" before the comma at the end.

(2) INFORMATION.—Section 6047 is amended by redesignating subsection (f) as subsection (g) and by inserting after subsection (e) the following new subsection:

"(f) DESIGNATED ROTH CONTRIBUTIONS.—The Secretary shall require the plan administrator of each applicable retirement plan (as defined in section 402A) to make such returns and reports regarding designated Roth contributions (as defined in section 402A) to the Secretary, participants and beneficiaries of the plan, and such other persons as the Secretary may prescribe.".

(e) CONFORMING AMENDMENTS.—

(1) Section 408A(e) is amended by adding after the first sentence the following new sentence: "Such term includes a rollover contribution described in section 402A(c)(3)(A).".

(2) The table of sections for subpart A of part I of subchapter D of chapter 1 is amended by inserting after the item relating to section 402 the following new item:

"Sec. 402A. Optional treatment of elective deferrals as Roth contributions.".

(f) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2005.

SEC. 618. NONREFUNDABLE CREDIT TO CERTAIN INDIVIDUALS FOR ELECTIVE DEFERRALS AND IRA CONTRIBUTIONS.

(a) IN GENERAL.—Subpart A of part IV of subchapter A of chapter 1 (relating to nonrefundable personal credits) is amended by inserting after section 25A the following new section:

"SEC. 25B. ELECTIVE DEFERRALS AND IRA CONTRIBUTIONS BY CERTAIN INDIVIDUALS.

"(a) ALLOWANCE OF CREDIT.—In the case of an eligible individual, there shall be allowed as a credit against the tax imposed by this subtitle for the taxable year an amount equal to the applicable percentage of so much of the qualified retirement savings contributions of the eligible individual for the taxable year as do not exceed $2,000.

"(b) APPLICABLE PERCENTAGE.—For purposes of this section, the applicable percentage is the percentage determined in accordance with the following table:

Adjusted Gross Income						Applicable percentage
Joint return		Head of a household		All other cases		
Over	Not over	Over	Not over	Over	Not over	
	$30,000		$22,500		$15,000	50
30,000	32,500	22,500	24,375	15,000	16,250	20

Adjusted Gross Income						Applicable percentage
Joint return		Head of a household		All other cases		
Over	Not over	Over	Not over	Over	Not over	
32,500	50,000	24,375	37,500	16,250	25,000	10
50,000		37,500		25,000		0

"(c) ELIGIBLE INDIVIDUAL.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible individual' means any individual if such individual has attained the age of 18 as of the close of the taxable year.

"(2) DEPENDENTS AND FULL-TIME STUDENTS NOT ELIGIBLE.—The term 'eligible individual' shall not include—

"(A) any individual with respect to whom a deduction under section 151 is allowed to another taxpayer for a taxable year beginning in the calendar year in which such individual's taxable year begins, and

"(B) any individual who is a student (as defined in section 151(c)(4)).

"(d) QUALIFIED RETIREMENT SAVINGS CONTRIBUTIONS.—For purposes of this section—

"(1) IN GENERAL.—The term 'qualified retirement savings contributions' means, with respect to any taxable year, the sum of—

"(A) the amount of the qualified retirement contributions (as defined in section 219(e)) made by the eligible individual,

"(B) the amount of—

"(i) any elective deferrals (as defined in section 402(g)(3)) of such individual, and

"(ii) any elective deferral of compensation by such individual under an eligible deferred compensation plan (as defined in section 457(b)) of an eligible employer described in section 457(e)(1)(A), and

"(C) the amount of voluntary employee contributions by such individual to any qualified retirement plan (as defined in section 4974(c)).

"(2) REDUCTION FOR CERTAIN DISTRIBUTIONS.—

"(A) IN GENERAL.—The qualified retirement savings contributions determined under paragraph (1) shall be reduced (but not below zero) by the sum of—

"(i) any distribution from a qualified retirement plan (as defined in section 4974(c)), or from an eligible deferred compensation plan (as defined in section 457(b)), received by the individual during the testing period which is includible in gross income, and

"(ii) any distribution from a Roth IRA or a Roth account received by the individual during the testing period which is not a qualified rollover contribution (as defined in section 408A(e)) to a Roth IRA or a rollover under section 402(c)(8)(B) to a Roth account.

"(B) TESTING PERIOD.—For purposes of subparagraph (A), the testing period, with respect to a taxable year, is the period which includes—

"(i) such taxable year,

"(ii) the 2 preceding taxable years, and

"(iii) the period after such taxable year and before the due date (including extensions) for filing the return of tax for such taxable year.

"(C) EXCEPTED DISTRIBUTIONS.—There shall not be taken into account under subparagraph (A)—

"(i) any distribution referred to in section 72(p), 401(k)(8), 401(m)(6), 402(g)(2), 404(k), or 408(d)(4), and

"(ii) any distribution to which section 408A(d)(3) applies.

"(D) TREATMENT OF DISTRIBUTIONS RECEIVED BY SPOUSE OF INDIVIDUAL.—For purposes of determining distributions received by an individual under subparagraph (A) for any taxable year, any distribution received by the spouse of such individual shall be treated as received by such individual if such individual and spouse file a joint return for such taxable year and for the taxable year during which the spouse receives the distribution.

"(e) ADJUSTED GROSS INCOME.—For purposes of this section, adjusted gross income shall be determined without regard to sections 911, 931, and 933.

"(f) INVESTMENT IN THE CONTRACT.—Notwithstanding any other provision of law, a qualified retirement savings contribution shall not fail to be included in determining the investment in the contract for purposes of section 72 by reason of the credit under this section.

"(g) TERMINATION.—This section shall not apply to taxable years beginning after December 31, 2006.".

(b) CREDIT ALLOWED AGAINST REGULAR TAX AND ALTERNATIVE MINIMUM TAX.—

(1) IN GENERAL.—Section 25B, as added by subsection (a), is amended by inserting after subsection (f) the following new subsection:

"(g) LIMITATION BASED ON AMOUNT OF TAX.—The credit allowed under subsection (a) for the taxable year shall not exceed the excess of—

"(1) the sum of the regular tax liability (as defined in section 26(b)) plus the tax imposed by section 55, over

"(2) the sum of the credits allowable under this subpart (other than this section and section 23) and section 27 for the taxable year."

(2) CONFORMING AMENDMENTS.—

(A) Section 24(b)(3)(B), as amended by sections 201(b) and 203(d), is amended by striking "section 23" and inserting "sections 23 and 25B".

(B) Section 25(e)(1)(C), as amended by section 201(b), is amended by inserting "25B," after "24,".

(C) Section 26(a)(1), as amended by sections 201(b) and 203, is amended by striking "and 24" and inserting ", 24, and 25B".

(D) Section 904(h), as amended by sections 201(b) and 203, is amended by striking "and 24" and inserting ", 24, and 25B".

(E) Section 1400C(d), as amended by sections 201(b) and 203, is amended by striking "and 24" and inserting ", 24, and 25B".

(c) CONFORMING AMENDMENT.—The table of sections for subpart A of part IV of subchapter A of chapter 1, as amended by section 432, is amended by inserting after the item relating to section 25A the following new item:

"Sec. 25B. Elective deferrals and IRA contributions by certain individuals."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 619. CREDIT FOR PENSION PLAN STARTUP COSTS OF SMALL EMPLOYERS.

(a) IN GENERAL.—Subpart D of part IV of subchapter A of chapter 1 (relating to business related credits) is amended by adding at the end the following new section:

"SEC. 45E. SMALL EMPLOYER PENSION PLAN STARTUP COSTS.

"(a) GENERAL RULE.—For purposes of section 38, in the case of an eligible employer, the small employer pension plan startup cost credit determined under this section for any taxable year is an amount equal to 50 percent of the qualified startup costs paid or incurred by the taxpayer during the taxable year.

"(b) DOLLAR LIMITATION.—The amount of the credit determined under this section for any taxable year shall not exceed—

"(1) $500 for the first credit year and each of the 2 taxable years immediately following the first credit year, and

"(2) zero for any other taxable year.

"(c) ELIGIBLE EMPLOYER.—For purposes of this section—

"(1) IN GENERAL.—The term 'eligible employer' has the meaning given such term by section 408(p)(2)(C)(i).

"(2) REQUIREMENT FOR NEW QUALIFIED EMPLOYER PLANS.—Such term shall not include an employer if, during the 3-taxable year period immediately preceding the 1st taxable year for which the credit under this section is otherwise allowable for a qualified employer plan of the employer, the employer or any member of any controlled group including the employer (or any predecessor of either) established or maintained a qualified employer plan with respect to which contributions were made, or benefits were accrued, for substantially the same employees as are in the qualified employer plan.

"(d) OTHER DEFINITIONS.—For purposes of this section—

"(1) QUALIFIED STARTUP COSTS.—

"(A) IN GENERAL.—The term 'qualified startup costs' means any ordinary and necessary expenses of an eligible employer which are paid or incurred in connection with—

"(i) the establishment or administration of an eligible employer plan, or

"(ii) the retirement-related education of employees with respect to such plan.

"(B) PLAN MUST HAVE AT LEAST 1 PARTICIPANT.—Such term shall not include any expense in connection with a plan that does not have at least 1 employee eligible to participate who is not a highly compensated employee.

"(2) ELIGIBLE EMPLOYER PLAN.—The term 'eligible employer plan' means a qualified employer plan within the meaning of section 4972(d).

"(3) FIRST CREDIT YEAR.—The term 'first credit year' means—

"(A) the taxable year which includes the date that the eligible employer plan to which such costs relate becomes effective, or

"(B) at the election of the eligible employer, the taxable year preceding the taxable year referred to in subparagraph (A).

"(e) SPECIAL RULES.—For purposes of this section—

"(1) AGGREGATION RULES.—All persons treated as a single employer under subsection (a) or (b) of section 52, or subsection (n) or (o) of section 414, shall be treated as one person. All eligible employer plans shall be treated as 1 eligible employer plan.

"(2) DISALLOWANCE OF DEDUCTION.—No deduction shall be allowed for that portion of the qualified startup costs paid or incurred for the taxable year which is equal to the credit determined under subsection (a).

"(3) ELECTION NOT TO CLAIM CREDIT.—This section shall not apply to a taxpayer for any taxable year if such taxpayer elects to have this section not apply for such taxable year."

(b) CREDIT ALLOWED AS PART OF GENERAL BUSINESS CREDIT.—Section 38(b) (defining current year business credit) is amended by striking "plus" at the end of paragraph (12), by striking the period at the end of paragraph (13) and inserting ", plus", and by adding at the end the following new paragraph:

"(14) in the case of an eligible employer (as defined in section 45E(c)), the small employer pension plan startup cost credit determined under section 45E(a)."

(c) CONFORMING AMENDMENTS.—

(1) Section 39(d) is amended by adding at the end the following new paragraph:

"(10) NO CARRYBACK OF SMALL EMPLOYER PENSION PLAN STARTUP COST CREDIT BEFORE JANUARY 1, 2002.—No portion of the unused business credit for any taxable year which is attributable to the small employer pension plan startup cost credit determined under section 45E may be carried back to a taxable year beginning before January 1, 2002."

(2) Subsection (c) of section 196 is amended by striking "and" at the end of paragraph (8), by striking the period at the end of paragraph (9) and inserting ", and", and by adding at the end the following new paragraph:

"(10) the small employer pension plan startup cost credit determined under section 45E(a)."

(3) The table of sections for subpart D of part IV of subchapter A of chapter 1 is amended by adding at the end the following new item:

"Sec. 45E. Small employer pension plan startup costs."

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to costs paid or incurred in taxable years beginning after December 31, 2001, with respect to qualified employer plans established after such date.

SEC. 620. ELIMINATION OF USER FEE FOR REQUESTS TO IRS REGARDING PENSION PLANS.

(a) ELIMINATION OF CERTAIN USER FEES.—The Secretary of the Treasury or the Secretary's delegate shall not require payment of user fees under the program established under section 10511 of the Revenue Act of 1987 for requests to the Internal Revenue Service for determination letters with respect to the qualified status of a pension benefit plan maintained solely by one or more eligible employers or any trust which is part of the plan. The preceding sentence shall not apply to any request—

(1) made after the later of—

(A) the fifth plan year the pension benefit plan is in existence; or

(B) the end of any remedial amendment period with respect to the plan beginning within the first 5 plan years; or

(2) made by the sponsor of any prototype or similar plan which the sponsor intends to market to participating employers.

(b) PENSION BENEFIT PLAN.—For purposes of this section, the term "pension benefit plan" means a pension, profit-sharing, stock bonus, annuity, or employee stock ownership plan.

(c) ELIGIBLE EMPLOYER.—For purposes of this section, the term "eligible employer" means an eligible employer (as defined in section 408(p)(2)(C)(i)(I) of the Internal Revenue Code of 1986) which has at least one employee who is not a highly compensated employee (as defined in section 414(q)) and is participating in the plan. The determination of whether an employer is an eligible employer under this section shall be made as of the date of the request described in subsection (a).

(d) DETERMINATION OF AVERAGE FEES CHARGED.—For purposes of any determination of average fees charged, any request to which subsection (a) applies shall not be taken into account.

(e) EFFECTIVE DATE.—The provisions of this section shall apply with respect to requests made after December 31, 2001.

SEC. 621. TREATMENT OF NONRESIDENT ALIENS ENGAGED IN INTERNATIONAL TRANSPORTATION SERVICES.

(a) EXCLUSION FROM INCOME SOURCING RULES.—The second sentence of section 861(a)(3) (relating to gross income from sources within the United States) is amended by striking "except for purposes of sections 79 and 105 and subchapter D,".

(b) EFFECTIVE DATE.—The amendment made by subsection (a) shall apply to remuneration for services performed in plan years beginning after December 31, 2001.

Subtitle C—Enhancing Fairness for Women

SEC. 631. CATCH-UP CONTRIBUTIONS FOR INDIVIDUALS AGE 50 OR OVER.

(a) IN GENERAL.—Section 414 (relating to definitions and special rules) is amended by adding at the end the following new subsection:

"(v) CATCH-UP CONTRIBUTIONS FOR INDIVIDUALS AGE 50 OR OVER.—

"(1) IN GENERAL.—An applicable employer plan shall not be treated as failing to meet any requirement of this title solely because the plan permits an eligible participant to make additional elective deferrals in any plan year.

"(2) LIMITATION ON AMOUNT OF ADDITIONAL DEFERRALS.—

"(A) IN GENERAL.—A plan shall not permit additional elective deferrals under paragraph (1) for any year in an amount greater than the lesser of—

"(i) the applicable dollar amount, or

"(ii) the excess (if any) of—

"(I) the participant's compensation (as defined in section 415(c)(3)) for the year, over

"(II) any other elective deferrals of the participant for such year which are made without regard to this subsection.

"(B) APPLICABLE DOLLAR AMOUNT.—For purposes of this paragraph—

"(i) In the case of an applicable employer plan other than a plan described in section 401(k)(11) or 408(p), the applicable dollar amount shall be determined in accordance with the following table:

"For taxable years beginning in:	***The applicable dollar amount is:***
2002	*$1,000*
2003	*$2,000*
2004	*$3,000*
2005	*$4,000*
2006 and thereafter	*$5,000.*

"(ii) In the case of an applicable employer plan described in section 401(k)(11) or 408(p), the applicable dollar amount shall be determined in accordance with the following table:

"For taxable years beginning in:	***The applicable dollar amount is:***
2002	*$500*
2003	*$1,000*
2004	*$1,500*
2005	*$2,000*
2006 and thereafter	*$2,500.*

"(C) COST-OF-LIVING ADJUSTMENT.—In the case of a year beginning after December 31, 2006, the Secretary shall adjust annually the $5,000 amount in subparagraph (B)(i) and the $2,500 amount in subparagraph (B)(ii) for increases in the cost-of-living at the same time and in the same manner as adjustments under section 415(d); except that the base period taken into account shall be the calendar quarter beginning July 1, 2005, and any increase under this subparagraph which is not a multiple of $500 shall be rounded to the next lower multiple of $500.".

"(3) TREATMENT OF CONTRIBUTIONS.—In the case of any contribution to a plan under paragraph (1)—

"(A) such contribution shall not, with respect to the year in which the contribution is made—

"(i) be subject to any otherwise applicable limitation contained in section 402(g), 402(h), 403(b), 404(a), 404(h), 408(k), 408(p), 415, or 457, or

"(ii) be taken into account in applying such limitations to other contributions or benefits under such plan or any other such plan, and

"(B) except as provided in paragraph (4), such plan shall not be treated as failing to meet the requirements of

section 401(a)(4), 401(a)(26), 401(k)(3), 401(k)(11), 401(k)(12), 403(b)(12), 408(k), 408(p), 408B, 410(b), or 416 by reason of the making of (or the right to make) such contribution.

"(4) APPLICATION OF NONDISCRIMINATION RULES.—

"(A) IN GENERAL.—An applicable employer plan shall be treated as failing to meet the nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features unless the plan allows all eligible participants to make the same election with respect to the additional elective deferrals under this subsection.

"(B) AGGREGATION.—For purposes of subparagraph (A), all plans maintained by employers who are treated as a single employer under subsection (b), (c), (m), or (o) of section 414 shall be treated as 1 plan.

"(5) ELIGIBLE PARTICIPANT.—For purposes of this subsection, the term 'eligible participant' means, with respect to any plan year, a participant in a plan—

"(A) who has attained the age of 50 before the close of the plan year, and

"(B) with respect to whom no other elective deferrals may (without regard to this subsection) be made to the plan for the plan year by reason of the application of any limitation or other restriction described in paragraph (3) or comparable limitation or restriction contained in the terms of the plan.

"(6) OTHER DEFINITIONS AND RULES.—For purposes of this subsection—

"(A) APPLICABLE EMPLOYER PLAN.—The term 'applicable employer plan' means—

"(i) an employees' trust described in section 401(a) which is exempt from tax under section 501(a),

"(ii) a plan under which amounts are contributed by an individual's employer for an annuity contract described in section 403(b),

"(iii) an eligible deferred compensation plan under section 457 of an eligible employer described in section 457(e)(1)(A), and

"(iv) an arrangement meeting the requirements of section 408 (k) or (p).

"(B) ELECTIVE DEFERRAL.—The term 'elective deferral' has the meaning given such term by subsection (u)(2)(C).

"(C) EXCEPTION FOR SECTION 457 PLANS.—This subsection shall not apply to an applicable employer plan described in subparagraph (A)(iii) for any year to which section 457(b)(3) applies.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to contributions in taxable years beginning after December 31, 2001.

SEC. 632. EQUITABLE TREATMENT FOR CONTRIBUTIONS OF EMPLOYEES TO DEFINED CONTRIBUTION PLANS.

(a) EQUITABLE TREATMENT.—

(1) IN GENERAL.—Subparagraph (B) of section 415(c)(1) (relating to limitation for defined contribution plans) is amended by striking "25 percent" and inserting "100 percent".

(2) APPLICATION TO SECTION 403(b).—Section 403(b) is amended—

(A) by striking "the exclusion allowance for such taxable year" in paragraph (1) and inserting "the applicable limit under section 415",

(B) by striking paragraph (2), and

(C) by inserting "or any amount received by a former employee after the fifth taxable year following the taxable year in which such employee was terminated" before the period at the end of the second sentence of paragraph (3).

(3) CONFORMING AMENDMENTS.—

(A) Subsection (f) of section 72 is amended by striking "section 403(b)(2)(D)(iii))" and inserting "section 403(b)(2)(D)(iii), as in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001".

(B) Section 404(a)(10)(B) is amended by striking ", the exclusion allowance under section 403(b)(2),".

(C) Section 415(a)(2) is amended by striking ", and the amount of the contribution for such portion shall reduce the exclusion allowance as provided in section 403(b)(2)".

(D) Section 415(c)(3) is amended by adding at the end the following new subparagraph:

"(E) ANNUITY CONTRACTS.—In the case of an annuity contract described in section 403(b), the term 'participant's compensation' means the participant's includible compensation determined under section 403(b)(3).".

(E) Section 415(c) is amended by striking paragraph (4).

(F) Section 415(c)(7) is amended to read as follows:

"(7) CERTAIN CONTRIBUTIONS BY CHURCH PLANS NOT TREATED AS EXCEEDING LIMIT.—

"(A) IN GENERAL.—Notwithstanding any other provision of this subsection, at the election of a participant who is an employee of a church or a convention or association of churches, including an organization described in section 414(e)(3)(B)(ii), contributions and other additions for an annuity contract or retirement income account described in section 403(b) with respect to such participant, when expressed as an annual addition to such participant's account, shall be treated as not exceeding the limitation of paragraph (1) if such annual addition is not in excess of $10,000.

"(B) $40,000 AGGREGATE LIMITATION.—The total amount of additions with respect to any participant which may be taken into account for purposes of this subparagraph for all years may not exceed $40,000.

"(C) ANNUAL ADDITION.—For purposes of this paragraph, the term 'annual addition' has the meaning given such term by paragraph (2).".

(G) Subparagraph (B) of section 402(g)(7) (as redesignated by section 611(c)(3)) is amended by inserting before the period at the end the following: "(as in effect before the enactment of the Economic Growth and Tax Relief Reconciliation Act of 2001".

(H) Section 664(g) is amended—

(i) in paragraph (3)(E) by striking "limitations under section 415(c)" and inserting "applicable limitation under paragraph (7)", and

(ii) by adding at the end the following new paragraph:

"(7) APPLICABLE LIMITATION.—

"(A) IN GENERAL.—For purposes of paragraph (3)(E), the applicable limitation under this paragraph with respect to a participant is an amount equal to the lesser of—

"(i) $30,000, or

"(ii) 25 percent of the participant's compensation (as defined in section 415(c)(3)).

"(B) COST-OF-LIVING ADJUSTMENT.—The Secretary shall adjust annually the $30,000 amount under subparagraph (A)(i) at the same time and in the same manner as under section 415(d), except that the base period shall be the calendar quarter beginning October 1, 1993, and any increase under this subparagraph which is not a multiple of $5,000 shall be rounded to the next lowest multiple of $5,000.".

(4) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2001.

(b) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—

(1) IN GENERAL.—Subsection (k) of section 415 is amended by adding at the end the following new paragraph:

"(4) SPECIAL RULES FOR SECTIONS 403(b) AND 408.—For purposes of this section, any annuity contract described in section 403(b) for the benefit of a participant shall be treated as a defined contribution plan maintained by each employer with respect to which the participant has the control required under subsection (b) or (c) of section 414 (as modified by subsection (h)). For purposes of this section, any contribution by an employer to a simplified employee pension plan for an individual for a taxable year shall be treated as an employer contribution to a defined contribution plan for such individual for such year.".

(2) EFFECTIVE DATE.—

(A) IN GENERAL.—The amendment made by paragraph (1) shall apply to limitation years beginning after December 31, 1999.

(B) EXCLUSION ALLOWANCE.—Effective for limitation years beginning in 2000, in the case of any annuity contract described in section 403(b) of the Internal Revenue Code of 1986, the amount of the contribution disqualified by reason of section 415(g) of such Code shall reduce the exclusion allowance as provided in section 403(b)(2) of such Code.

(3) ELECTION TO MODIFY SECTION 403(b) EXCLUSION ALLOWANCE TO CONFORM TO SECTION 415 MODIFICATION.—In the case of taxable years beginning after December 31, 1999, and before January 1, 2002, a plan may disregard the requirement in the regulations regarding the exclusion allowance under section 403(b)(2) of the Internal Revenue Code of 1986 that contribu-

tions to a defined benefit pension plan be treated as previously excluded amounts for purposes of the exclusion allowance.

(c) DEFERRED COMPENSATION PLANS OF STATE AND LOCAL GOVERNMENTS AND TAX-EXEMPT ORGANIZATIONS.—

(1) IN GENERAL.—Subparagraph (B) of section 457(b)(2) (relating to salary limitation on eligible deferred compensation plans) is amended by striking "33⅓ percent" and inserting "100 percent".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to years beginning after December 31, 2001.

SEC. 633. FASTER VESTING OF CERTAIN EMPLOYER MATCHING CONTRIBUTIONS.

(a) IN GENERAL.—Section 411(a) (relating to minimum vesting standards) is amended—

(1) in paragraph (2), by striking "A plan" and inserting "Except as provided in paragraph (12), a plan"; and

(2) by adding at the end the following:

"(12) FASTER VESTING FOR MATCHING CONTRIBUTIONS.—In the case of matching contributions (as defined in section 401(m)(4)(A)), paragraph (2) shall be applied—

"(A) by substituting '3 years' for '5 years' in subparagraph (A), and

"(B) by substituting the following table for the table contained in subparagraph (B):

"Years of service:	***The nonforfeitable percentage is:***
2	*20*
3	*40*
4	*60*
5	*80*
6	*100.".*

(b) AMENDMENT OF ERISA.—Section 203(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(a)) is amended—

(1) in paragraph (2), by striking "A plan" and inserting "Except as provided in paragraph (4), a plan", and

(2) by adding at the end the following:

"(4) In the case of matching contributions (as defined in section 401(m)(4)(A) of the Internal Revenue Code of 1986), paragraph (2) shall be applied—

"(A) by substituting '3 years' for '5 years' in subparagraph (A), and

"(B) by substituting the following table for the table contained in subparagraph (B):

"Years of service:	***The nonforfeitable percentage is:***
2	*20*
3	*40*
4	*60*
5	*80*
6	*100.".*

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to contributions for plan years beginning after December 31, 2001.

(2) COLLECTIVE BARGAINING AGREEMENTS.—In the case of a plan maintained pursuant to one or more collective bargaining

agreements between employee representatives and one or more employers ratified by the date of the enactment of this Act, the amendments made by this section shall not apply to contributions on behalf of employees covered by any such agreement for plan years beginning before the earlier of—

(A) the later of—

(i) the date on which the last of such collective bargaining agreements terminates (determined without regard to any extension thereof on or after such date of the enactment); or

(ii) January 1, 2002; or

(B) January 1, 2006.

(3) SERVICE REQUIRED.—With respect to any plan, the amendments made by this section shall not apply to any employee before the date that such employee has 1 hour of service under such plan in any plan year to which the amendments made by this section apply.

SEC. 634. MODIFICATION TO MINIMUM DISTRIBUTION RULES.

The Secretary of the Treasury shall modify the life expectancy tables under the regulations relating to minimum distribution requirements under sections 401(a)(9), 408(a)(6) and (b)(3), 403(b)(10), and 457(d)(2) of the Internal Revenue Code to reflect current life expectancy.

SEC. 635. CLARIFICATION OF TAX TREATMENT OF DIVISION OF SECTION 457 PLAN BENEFITS UPON DIVORCE.

(a) IN GENERAL.—Section 414(p)(11) (relating to application of rules to governmental and church plans) is amended—

(1) by inserting "or an eligible deferred compensation plan (within the meaning of section 457(b))" after "subsection (e))"; and

(2) in the heading, by striking "GOVERNMENTAL AND CHURCH PLANS" and inserting "CERTAIN OTHER PLANS".

(b) WAIVER OF CERTAIN DISTRIBUTION REQUIREMENTS.—Paragraph (10) of section 414(p) is amended by striking "and section 409(d)" and inserting "section 409(d), and section 457(d)".

(c) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—Subsection (p) of section 414 is amended by redesignating paragraph (12) as paragraph (13) and inserting after paragraph (11) the following new paragraph:

"(12) TAX TREATMENT OF PAYMENTS FROM A SECTION 457 PLAN.—If a distribution or payment from an eligible deferred compensation plan described in section 457(b) is made pursuant to a qualified domestic relations order, rules similar to the rules of section 402(e)(1)(A) shall apply to such distribution or payment.".

(d) EFFECTIVE DATE.—The amendment made by this section shall apply to transfers, distributions, and payments made after December 31, 2001.

SEC. 636. PROVISIONS RELATING TO HARDSHIP DISTRIBUTIONS.

(a) SAFE HARBOR RELIEF.—

(1) IN GENERAL.—The Secretary of the Treasury shall revise the regulations relating to hardship distributions under section 401(k)(2)(B)(i)(IV) of the Internal Revenue Code of 1986 to provide that the period an employee is prohibited from making

elective and employee contributions in order for a distribution to be deemed necessary to satisfy financial need shall be equal to 6 months.

(2) EFFECTIVE DATE.—The revised regulations under this subsection shall apply to years beginning after December 31, 2001.

(b) HARDSHIP DISTRIBUTIONS NOT TREATED AS ELIGIBLE ROLLOVER DISTRIBUTIONS.—

(1) MODIFICATION OF DEFINITION OF ELIGIBLE ROLLOVER.—Subparagraph (C) of section 402(c)(4) (relating to eligible rollover distribution) is amended to read as follows:

"(C) any distribution which is made upon hardship of the employee.".

(2) EFFECTIVE DATE.—The amendment made by this subsection shall apply to distributions made after December 31, 2001.

SEC. 637. WAIVER OF TAX ON NONDEDUCTIBLE CONTRIBUTIONS FOR DOMESTIC OR SIMILAR WORKERS.

(a) IN GENERAL.—Section 4972(c)(6) (relating to exceptions to nondeductible contributions), as amended by section 616, is amended by striking "and" at the end of subparagraph (A), by striking the period and inserting ", or" at the end of subparagraph (B), and by inserting after subparagraph (B) the following new subparagraph:

"(C) so much of the contributions to a simple retirement account (within the meaning of section 408(p)) or a simple plan (within the meaning of section 401(k)(11)) which are not deductible when contributed solely because such contributions are not made in connection with a trade or business of the employer."

(b) EXCLUSION OF CERTAIN CONTRIBUTIONS.—Section 4972(c)(6), as amended by subsection (a), is amended by adding at the end the following new sentence: "Subparagraph (C) shall not apply to contributions made on behalf of the employer or a member of the employer's family (as defined in section 447(e)(1)).".

(c) NO INFERENCE.—Nothing in the amendments made by this section shall be construed to infer the proper treatment of nondeductible contributions under the laws in effect before such amendments.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

Subtitle D—Increasing Portability for Participants

SEC. 641. ROLLOVERS ALLOWED AMONG VARIOUS TYPES OF PLANS.

(a) ROLLOVERS FROM AND TO SECTION 457 PLANS.—

(1) ROLLOVERS FROM SECTION 457 PLANS.—

(A) IN GENERAL.—Section 457(e) (relating to other definitions and special rules) is amended by adding at the end the following:

"(16) ROLLOVER AMOUNTS.—

"(A) GENERAL RULE.—In the case of an eligible deferred compensation plan established and maintained by an employer described in subsection (e)(1)(A), if—

"(i) any portion of the balance to the credit of an employee in such plan is paid to such employee in an

eligible rollover distribution (within the meaning of section 402(c)(4)),

"(ii) the employee transfers any portion of the property such employee receives in such distribution to an eligible retirement plan described in section 402(c)(8)(B), and

"(iii) in the case of a distribution of property other than money, the amount so transferred consists of the property distributed,

then such distribution (to the extent so transferred) shall not be includible in gross income for the taxable year in which paid.

"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A).

"(C) REPORTING.—Rollovers under this paragraph shall be reported to the Secretary in the same manner as rollovers from qualified retirement plans (as defined in section 4974(c)).".

(B) DEFERRAL LIMIT DETERMINED WITHOUT REGARD TO ROLLOVER AMOUNTS.—Section 457(b)(2) (defining eligible deferred compensation plan) is amended by inserting "(other than rollover amounts)" after "taxable year".

(C) DIRECT ROLLOVER.—Paragraph (1) of section 457(d) is amended by striking "and" at the end of subparagraph (A), by striking the period at the end of subparagraph (B) and inserting ", and", and by inserting after subparagraph (B) the following:

"(C) in the case of a plan maintained by an employer described in subsection (e)(1)(A), the plan meets requirements similar to the requirements of section 401(a)(31).

Any amount transferred in a direct trustee-to-trustee transfer in accordance with section 401(a)(31) shall not be includible in gross income for the taxable year of transfer.".

(D) WITHHOLDING.—

(i) Paragraph (12) of section 3401(a) is amended by adding at the end the following:

"(E) under or to an eligible deferred compensation plan which, at the time of such payment, is a plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A), or".

(ii) Paragraph (3) of section 3405(c) is amended to read as follows:

"(3) ELIGIBLE ROLLOVER DISTRIBUTION.—For purposes of this subsection, the term 'eligible rollover distribution' has the meaning given such term by section 402(f)(2)(A).".

(iii) LIABILITY FOR WITHHOLDING.—Subparagraph (B) of section 3405(d)(2) is amended by striking "or" at the end of clause (ii), by striking the period at the end of clause (iii) and inserting ", or", and by adding at the end the following:

"(iv) section 457(b) and which is maintained by an eligible employer described in section 457(e)(1)(A).".

(2) ROLLOVERS TO SECTION 457 PLANS.—

(A) IN GENERAL.—Section 402(c)(8)(B) (defining eligible retirement plan) is amended by striking "and" at the end of clause (iii), by striking the period at the end of clause (iv) and inserting ", and", and by inserting after clause (iv) the following new clause:

"(v) an eligible deferred compensation plan described in section 457(b) which is maintained by an eligible employer described in section 457(e)(1)(A).".

(B) SEPARATE ACCOUNTING.—Section 402(c) is amended by adding at the end the following new paragraph:

"(10) SEPARATE ACCOUNTING.—Unless a plan described in clause (v) of paragraph (8)(B) agrees to separately account for amounts rolled into such plan from eligible retirement plans not described in such clause, the plan described in such clause may not accept transfers or rollovers from such retirement plans.".

(C) 10 PERCENT ADDITIONAL TAX.—Subsection (t) of section 72 (relating to 10-percent additional tax on early distributions from qualified retirement plans) is amended by adding at the end the following new paragraph:

"(9) SPECIAL RULE FOR ROLLOVERS TO SECTION 457 PLANS.—For purposes of this subsection, a distribution from an eligible deferred compensation plan (as defined in section 457(b)) of an eligible employer described in section 457(e)(1)(A) shall be treated as a distribution from a qualified retirement plan described in 4974(c)(1) to the extent that such distribution is attributable to an amount transferred to an eligible deferred compensation plan from a qualified retirement plan (as defined in section 4974(c)).".

(b) ALLOWANCE OF ROLLOVERS FROM AND TO 403(b) PLANS.—

(1) ROLLOVERS FROM SECTION 403(b) PLANS.—Section 403(b)(8)(A)(ii) (relating to rollover amounts) is amended by striking "such distribution" and all that follows and inserting "such distribution to an eligible retirement plan described in section 402(c)(8)(B), and".

(2) ROLLOVERS TO SECTION 403(b) PLANS.—Section 402(c)(8)(B) (defining eligible retirement plan), as amended by subsection (a), is amended by striking "and" at the end of clause (iv), by striking the period at the end of clause (v) and inserting ", and", and by inserting after clause (v) the following new clause:

"(vi) an annuity contract described in section 403(b).".

(c) EXPANDED EXPLANATION TO RECIPIENTS OF ROLLOVER DISTRIBUTIONS.—Paragraph (1) of section 402(f) (relating to written explanation to recipients of distributions eligible for rollover treatment) is amended by striking "and" at the end of subparagraph (C), by striking the period at the end of subparagraph (D) and inserting ", and", and by adding at the end the following new subparagraph:

"(E) of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making such distribution.".

(d) SPOUSAL ROLLOVERS.—Section 402(c)(9) (relating to rollover where spouse receives distribution after death of employee) is amended by striking "; except that" and all that follows up to the end period.

(e) CONFORMING AMENDMENTS.—

(1) Section 72(o)(4) is amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(2) Section 219(d)(2) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(3) Section 401(a)(31)(B) is amended by striking "and 403(a)(4)" and inserting ", 403(a)(4), 403(b)(8), and 457(e)(16)".

(4) Subparagraph (A) of section 402(f)(2) is amended by striking "or paragraph (4) of section 403(a)" and inserting ", paragraph (4) of section 403(a), subparagraph (A) of section 403(b)(8), or subparagraph (A) of section 457(e)(16)".

(5) Paragraph (1) of section 402(f) is amended by striking "from an eligible retirement plan".

(6) Subparagraphs (A) and (B) of section 402(f)(1) are amended by striking "another eligible retirement plan" and inserting "an eligible retirement plan".

(7) Subparagraph (B) of section 403(b)(8) is amended to read as follows:

"(B) CERTAIN RULES MADE APPLICABLE.—The rules of paragraphs (2) through (7) and (9) of section 402(c) and section 402(f) shall apply for purposes of subparagraph (A), except that section 402(f) shall be applied to the payor in lieu of the plan administrator.".

(8) Section 408(a)(1) is amended by striking "or 403(b)(8)," and inserting "403(b)(8), or 457(e)(16)".

(9) Subparagraphs (A) and (B) of section 415(b)(2) are each amended by striking "and 408(d)(3)" and inserting "403(b)(8), 408(d)(3), and 457(e)(16)".

(10) Section 415(c)(2) is amended by striking "and 408(d)(3)" and inserting "408(d)(3), and 457(e)(16)".

(11) Section 4973(b)(1)(A) is amended by striking "or 408(d)(3)" and inserting "408(d)(3), or 457(e)(16)".

(f) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2001.

(2) REASONABLE NOTICE.—No penalty shall be imposed on a plan for the failure to provide the information required by the amendment made by subsection (c) with respect to any distribution made before the date that is 90 days after the date on which the Secretary of the Treasury issues a safe harbor rollover notice after the date of the enactment of this Act, if the administrator of such plan makes a reasonable attempt to comply with such requirement.

(3) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of any amendment made by this section.

SEC. 642. ROLLOVERS OF IRAS INTO WORKPLACE RETIREMENT PLANS.

(a) IN GENERAL.—Subparagraph (A) of section 408(d)(3) (relating to rollover amounts) is amended by adding "or" at the end of clause (i), by striking clauses (ii) and (iii), and by adding at the end the following:

> *"(ii) the entire amount received (including money and any other property) is paid into an eligible retirement plan for the benefit of such individual not later than the 60th day after the date on which the payment or distribution is received, except that the maximum amount which may be paid into such plan may not exceed the portion of the amount received which is includible in gross income (determined without regard to this paragraph).*

For purposes of clause (ii), the term 'eligible retirement plan' means an eligible retirement plan described in clause (iii), (iv), (v), or (vi) of section 402(c)(8)(B).".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 403(b) is amended by striking "section 408(d)(3)(A)(iii)" and inserting "section 408(d)(3)(A)(ii)".

(2) Clause (i) of section 408(d)(3)(D) is amended by striking "(i), (ii), or (iii)" and inserting "(i) or (ii)".

(3) Subparagraph (G) of section 408(d)(3) is amended to read as follows:

> *"(G) SIMPLE RETIREMENT ACCOUNTS.—In the case of any payment or distribution out of a simple retirement account (as defined in subsection (p)) to which section 72(t)(6) applies, this paragraph shall not apply unless such payment or distribution is paid into another simple retirement account.".*

(c) EFFECTIVE DATE; SPECIAL RULE.—

(1) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2001.

(2) SPECIAL RULE.—Notwithstanding any other provision of law, subsections (h)(3) and (h)(5) of section 1122 of the Tax Reform Act of 1986 shall not apply to any distribution from an eligible retirement plan (as defined in clause (iii) or (iv) of section 402(c)(8)(B) of the Internal Revenue Code of 1986) on behalf of an individual if there was a rollover to such plan on behalf of such individual which is permitted solely by reason of the amendments made by this section.

SEC. 643. ROLLOVERS OF AFTER-TAX CONTRIBUTIONS.

(a) ROLLOVERS FROM EXEMPT TRUSTS.—Paragraph (2) of section 402(c) (relating to maximum amount which may be rolled over) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution to the extent—

> *"(A) such portion is transferred in a direct trustee-to-trustee transfer to a qualified trust which is part of a plan which is a defined contribution plan and which agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or*

"(B) such portion is transferred to an eligible retirement plan described in clause (i) or (ii) of paragraph (8)(B).".

(b) OPTIONAL DIRECT TRANSFER OF ELIGIBLE ROLLOVER DISTRIBUTIONS.—Subparagraph (B) of section 401(a)(31) (relating to limitation) is amended by adding at the end the following: "The preceding sentence shall not apply to such distribution if the plan to which such distribution is transferred—

"(i) agrees to separately account for amounts so transferred, including separately accounting for the portion of such distribution which is includible in gross income and the portion of such distribution which is not so includible, or

"(ii) is an eligible retirement plan described in clause (i) or (ii) of section 402(c)(8)(B).".

(c) RULES FOR APPLYING SECTION 72 TO IRAS.—Paragraph (3) of section 408(d) (relating to special rules for applying section 72) is amended by inserting at the end the following:

"(H) APPLICATION OF SECTION 72.—

"(i) IN GENERAL.—If—

"(I) a distribution is made from an individual retirement plan, and

"(II) a rollover contribution is made to an eligible retirement plan described in section 402(c)(8)(B)(iii), (iv), (v), or (vi) with respect to all or part of such distribution,

then, notwithstanding paragraph (2), the rules of clause (ii) shall apply for purposes of applying section 72.

"(ii) APPLICABLE RULES.—In the case of a distribution described in clause (i)—

"(I) section 72 shall be applied separately to such distribution,

"(II) notwithstanding the pro rata allocation of income on, and investment in, the contract to distributions under section 72, the portion of such distribution rolled over to an eligible retirement plan described in clause (i) shall be treated as from income on the contract (to the extent of the aggregate income on the contract from all individual retirement plans of the distributee), and

"(III) appropriate adjustments shall be made in applying section 72 to other distributions in such taxable year and subsequent taxable years.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after December 31, 2001.

SEC. 644. HARDSHIP EXCEPTION TO 60-DAY RULE.

(a) EXEMPT TRUSTS.—Paragraph (3) of section 402(c) (relating to transfer must be made within 60 days of receipt) is amended to read as follows:

"(3) TRANSFER MUST BE MADE WITHIN 60 DAYS OF RECEIPT.—

"(A) IN GENERAL.—Except as provided in subparagraph (B), paragraph (1) shall not apply to any transfer of a dis-

tribution made after the 60th day following the day on which the distributee received the property distributed.

"(B) HARDSHIP EXCEPTION.—The Secretary may waive the 60-day requirement under subparagraph (A) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(b) IRAS.—Paragraph (3) of section 408(d) (relating to rollover contributions), as amended by section 643, is amended by adding after subparagraph (H) the following new subparagraph:

"(I) WAIVER OF 60-DAY REQUIREMENT.—The Secretary may waive the 60-day requirement under subparagraphs (A) and (D) where the failure to waive such requirement would be against equity or good conscience, including casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2001.

SEC. 645. TREATMENT OF FORMS OF DISTRIBUTION.

(a) PLAN TRANSFERS.—

(1) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (6) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended by adding at the end the following:

"(D) PLAN TRANSFERS.—

"(i) IN GENERAL.—A defined contribution plan (in this subparagraph referred to as the 'transferee plan') shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the 'transferor plan') to the extent that—

"(I) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan,

"(II) the terms of both the transferor plan and the transferee plan authorize the transfer described in subclause (I),

"(III) the transfer described in subclause (I) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan,

"(IV) the election described in subclause (III) was made after the participant or beneficiary received a notice describing the consequences of making the election, and

"(V) the transferee plan allows the participant or beneficiary described in subclause (III) to receive any distribution to which the participant or

beneficiary is entitled under the transferee plan in the form of a single sum distribution.

"(ii) SPECIAL RULE FOR MERGERS, ETC.—Clause (i) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

"(E) ELIMINATION OF FORM OF DISTRIBUTION.—Except to the extent provided in regulations, a defined contribution plan shall not be treated as failing to meet the requirements of this section merely because of the elimination of a form of distribution previously available thereunder. This subparagraph shall not apply to the elimination of a form of distribution with respect to any participant unless—

"(i) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated, and

"(ii) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.".

(2) AMENDMENT OF ERISA.—Section 204(g) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(g)) is amended by adding at the end the following:

"(4)(A) A defined contribution plan (in this subparagraph referred to as the 'transferee plan') shall not be treated as failing to meet the requirements of this subsection merely because the transferee plan does not provide some or all of the forms of distribution previously available under another defined contribution plan (in this subparagraph referred to as the 'transferor plan') to the extent that—

"(i) the forms of distribution previously available under the transferor plan applied to the account of a participant or beneficiary under the transferor plan that was transferred from the transferor plan to the transferee plan pursuant to a direct transfer rather than pursuant to a distribution from the transferor plan;

"(ii) the terms of both the transferor plan and the transferee plan authorize the transfer described in clause (i);

"(iii) the transfer described in clause (i) was made pursuant to a voluntary election by the participant or beneficiary whose account was transferred to the transferee plan;

"(iv) the election described in clause (iii) was made after the participant or beneficiary received a notice describing the consequences of making the election; and

"(v) the transferee plan allows the participant or beneficiary described in clause (iii) to receive any distribution to which the participant or beneficiary is entitled under the transferee plan in the form of a single sum distribution.

"(B) Subparagraph (A) shall apply to plan mergers and other transactions having the effect of a direct transfer, including consolidations of benefits attributable to different employers within a multiple employer plan.

"(5) Except to the extent provided in regulations promulgated by the Secretary of the Treasury, a defined contribution plan shall not be treated as failing to meet the requirements of this subsection

merely because of the elimination of a form of distribution previously available thereunder. This paragraph shall not apply to the elimination of a form of distribution with respect to any participant unless—

"(A) a single sum payment is available to such participant at the same time or times as the form of distribution being eliminated; and

"(B) such single sum payment is based on the same or greater portion of the participant's account as the form of distribution being eliminated.".

(3) EFFECTIVE DATE.—The amendments made by this subsection shall apply to years beginning after December 31, 2001.

(b) REGULATIONS.—

(1) AMENDMENT OF INTERNAL REVENUE CODE.—Paragraph (6)(B) of section 411(d) (relating to accrued benefit not to be decreased by amendment) is amended by inserting after the second sentence the following: "The Secretary shall by regulations provide that this subparagraph shall not apply to any plan amendment which reduces or eliminates benefits or subsidies which create significant burdens or complexities for the plan and plan participants, unless such amendment adversely affects the rights of any participant in a more than de minimis manner.".

(2) AMENDMENT OF ERISA.—Section 204(g)(2) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054(g)(2)) is amended by inserting after the second sentence the following: "The Secretary of the Treasury shall by regulations provide that this paragraph shall not apply to any plan amendment which reduces or eliminates benefits or subsidies which create significant burdens or complexities for the plan and plan participants, unless such amendment adversely affects the rights of any participant in a more than de minimis manner.".

(3) SECRETARY DIRECTED.—Not later than December 31, 2003, the Secretary of the Treasury is directed to issue regulations under section 411(d)(6) of the Internal Revenue Code of 1986 and section 204(g) of the Employee Retirement Income Security Act of 1974, including the regulations required by the amendment made by this subsection. Such regulations shall apply to plan years beginning after December 31, 2003, or such earlier date as is specified by the Secretary of the Treasury.

SEC. 646. RATIONALIZATION OF RESTRICTIONS ON DISTRIBUTIONS.

(a) MODIFICATION OF SAME DESK EXCEPTION.—

(1) SECTION 401(k).—

(A) Section 401(k)(2)(B)(i)(I) (relating to qualified cash or deferred arrangements) is amended by striking "separation from service" and inserting "severance from employment".

(B) Subparagraph (A) of section 401(k)(10) (relating to distributions upon termination of plan or disposition of assets or subsidiary) is amended to read as follows:

"(A) IN GENERAL.—An event described in this subparagraph is the termination of the plan without establishment or maintenance of another defined contribution plan (other

than an employee stock ownership plan as defined in section 4975(e)(7)).".

(C) Section 401(k)(10) is amended—

(i) in subparagraph (B)—

(I) by striking "An event" in clause (i) and inserting "A termination"; and

(II) by striking "the event" in clause (i) and inserting "the termination";

(ii) by striking subparagraph (C); and

(iii) by striking "OR DISPOSITION OF ASSETS OR SUBSIDIARY" in the heading.

(2) SECTION 403(b).—

(A) Paragraphs (7)(A)(ii) and (11)(A) of section 403(b) are each amended by striking "separates from service" and inserting "has a severance from employment".

(B) The heading for paragraph (11) of section 403(b) is amended by striking "SEPARATION FROM SERVICE" and inserting "SEVERANCE FROM EMPLOYMENT".

(3) SECTION 457.—Clause (ii) of section 457(d)(1)(A) is amended by striking "is separated from service" and inserting "has a severance from employment".

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2001.

SEC. 647. PURCHASE OF SERVICE CREDIT IN GOVERNMENTAL DEFINED BENEFIT PLANS.

(a) SECTION 403(b) PLANS.—Subsection (b) of section 403 is amended by adding at the end the following new paragraph:

"(13) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(b) SECTION 457 PLANS.—Subsection (e) of section 457, as amended by section 641, is amended by adding after paragraph (16) the following new paragraph:

"(17) TRUSTEE-TO-TRUSTEE TRANSFERS TO PURCHASE PERMISSIVE SERVICE CREDIT.—No amount shall be includible in gross income by reason of a direct trustee-to-trustee transfer to a defined benefit governmental plan (as defined in section 414(d)) if such transfer is—

"(A) for the purchase of permissive service credit (as defined in section 415(n)(3)(A)) under such plan, or

"(B) a repayment to which section 415 does not apply by reason of subsection (k)(3) thereof.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to trustee-to-trustee transfers after December 31, 2001.

SEC. 648. EMPLOYERS MAY DISREGARD ROLLOVERS FOR PURPOSES OF CASH-OUT AMOUNTS.

(a) QUALIFIED PLANS.—

(1) AMENDMENT OF INTERNAL REVENUE CODE.—Section 411(a)(11) (relating to restrictions on certain mandatory distributions) is amended by adding at the end the following:

"(D) SPECIAL RULE FOR ROLLOVER CONTRIBUTIONS.—A plan shall not fail to meet the requirements of this paragraph if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For purposes of this subparagraph, the term 'rollover contributions' means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16).".

(2) AMENDMENT OF ERISA.—Section 203(e) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(c)) is amended by adding at the end the following:

"(4) A plan shall not fail to meet the requirements of this subsection if, under the terms of the plan, the present value of the nonforfeitable accrued benefit is determined without regard to that portion of such benefit which is attributable to rollover contributions (and earnings allocable thereto). For purposes of this subparagraph, the term 'rollover contributions' means any rollover contribution under sections 402(c), 403(a)(4), 403(b)(8), 408(d)(3)(A)(ii), and 457(e)(16) of the Internal Revenue Code of 1986.".

(b) ELIGIBLE DEFERRED COMPENSATION PLANS.—Clause (i) of section 457(e)(9)(A) is amended by striking "such amount" and inserting "the portion of such amount which is not attributable to rollover contributions (as defined in section 411(a)(11)(D))".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions after December 31, 2001.

SEC. 649. MINIMUM DISTRIBUTION AND INCLUSION REQUIREMENTS FOR SECTION 457 PLANS.

(a) MINIMUM DISTRIBUTION REQUIREMENTS.—Paragraph (2) of section 457(d) (relating to distribution requirements) is amended to read as follows:

"(2) MINIMUM DISTRIBUTION REQUIREMENTS.—A plan meets the minimum distribution requirements of this paragraph if such plan meets the requirements of section 401(a)(9).".

(b) INCLUSION IN GROSS INCOME.—

(1) YEAR OF INCLUSION.—Subsection (a) of section 457 (relating to year of inclusion in gross income) is amended to read as follows:

"(a) YEAR OF INCLUSION IN GROSS INCOME.—

"(1) IN GENERAL.—Any amount of compensation deferred under an eligible deferred compensation plan, and any income attributable to the amounts so deferred, shall be includible in gross income only for the taxable year in which such compensation or other income—

"(A) is paid to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(A), and

"(B) is paid or otherwise made available to the participant or other beneficiary, in the case of a plan of an eligible employer described in subsection (e)(1)(B).

"(2) SPECIAL RULE FOR ROLLOVER AMOUNTS.—To the extent provided in section 72(t)(9), section 72(t) shall apply to any amount includible in gross income under this subsection.".

(2) CONFORMING AMENDMENTS.—

(A) So much of paragraph (9) of section 457(e) as precedes subparagraph (A) is amended to read as follows:

"(9) BENEFITS OF TAX EXEMPT ORGANIZATION PLANS NOT TREATED AS MADE AVAILABLE BY REASON OF CERTAIN ELECTIONS, ETC.—In the case of an eligible deferred compensation plan of an employer described in subsection (e)(1)(B)—".

(B) Section 457(d) is amended by adding at the end the following new paragraph:

"(3) SPECIAL RULE FOR GOVERNMENT PLAN.—An eligible deferred compensation plan of an employer described in subsection (e)(1)(A) shall not be treated as failing to meet the requirements of this subsection solely by reason of making a distribution described in subsection (e)(9)(A).".

(c) EFFECTIVE DATE.—The amendments made by subsections (a) and (b) shall apply to distributions after December 31, 2001.

Subtitle E—Strengthening Pension Security and Enforcement

PART I—GENERAL PROVISIONS

SEC. 651. REPEAL OF 160 PERCENT OF CURRENT LIABILITY FUNDING LIMIT.

(a) AMENDMENTS TO INTERNAL REVENUE CODE.—Section 412(c)(7) (relating to full-funding limitation) is amended—

(1) by striking "the applicable percentage" in subparagraph (A)(i)(I) and inserting "in the case of plan years beginning before January 1, 2004, the applicable percentage"; and

(2) by amending subparagraph (F) to read as follows:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in—	*The applicable percentage is—*
2002	*165*
2003	*170.".*

(b) AMENDMENT OF ERISA.—Section 302(c)(7) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1082(c)(7)) is amended—

(1) by striking "the applicable percentage" in subparagraph (A)(i)(I) and inserting "in the case of plan years beginning before January 1, 2004, the applicable percentage", and

(2) by amending subparagraph (F) to read as follows:

"(F) APPLICABLE PERCENTAGE.—For purposes of subparagraph (A)(i)(I), the applicable percentage shall be determined in accordance with the following table:

"In the case of any plan year beginning in alendar year—	*The applicable percentage is—*
2002	*165*
2003	*170.".*

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2001.

SEC. 652. MAXIMUM CONTRIBUTION DEDUCTION RULES MODIFIED AND APPLIED TO ALL DEFINED BENEFIT PLANS.

(a) IN GENERAL.—Subparagraph (D) of section 404(a)(1) (relating to special rule in case of certain plans) is amended to read as follows:

"(D) SPECIAL RULE IN CASE OF CERTAIN PLANS.—

"(i) IN GENERAL.—In the case of any defined benefit plan, except as provided in regulations, the maximum amount deductible under the limitations of this paragraph shall not be less than the unfunded current liability determined under section 412(l).

"(ii) PLANS WITH 100 OR LESS PARTICIPANTS.—For purposes of this subparagraph, in the case of a plan which has 100 or less participants for the plan year, unfunded current liability shall not include the liability attributable to benefit increases for highly compensated employees (as defined in section 414(q)) resulting from a plan amendment which is made or becomes effective, whichever is later, within the last 2 years.

"(iii) RULE FOR DETERMINING NUMBER OF PARTICIPANTS.—For purposes of determining the number of plan participants, all defined benefit plans maintained by the same employer (or any member of such employer's controlled group (within the meaning of section 412(l)(8)(C))) shall be treated as one plan, but only employees of such member or employer shall be taken into account.

"(iv) PLANS MAINTAINED BY PROFESSIONAL SERVICE EMPLOYERS.—In the case of a plan which, subject to section 4041 of the Employee Retirement Income Security Act of 1974, terminates during the plan year, clause (i) shall be applied by substituting for unfunded current liability the amount required to make the plan sufficient for benefit liabilities (within the meaning of section 4041(d) of such Act).".

(b) CONFORMING AMENDMENT.—Paragraph (6) of section 4972(c), as amended by sections 616 and 637, is amended—

(1) by striking subparagraph (A) and redesignating subparagraphs (B) and (C) as subparagraphs (A) and (B), respectively,

(2) by striking the first sentence following subparagraph (B) (as so redesignated),

(3) by striking "subparagraph (B)" in the next to last sentence and inserting "subparagraph (A)", and

(4) by striking "Subparagraph (C)" in the last sentence and inserting "Subparagraph (B)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2001.

SEC. 653. EXCISE TAX RELIEF FOR SOUND PENSION FUNDING.

(a) IN GENERAL.—Subsection (c) of section 4972 (relating to nondeductible contributions) is amended by adding at the end the following new paragraph:

"(7) DEFINED BENEFIT PLAN EXCEPTION.—In determining the amount of nondeductible contributions for any taxable year,

an employer may elect for such year not to take into account any contributions to a defined benefit plan except to the extent that such contributions exceed the full-funding limitation (as defined in section 412(c)(7), determined without regard to subparagraph (A)(i)(I) thereof). For purposes of this paragraph, the deductible limits under section 404(a)(7) shall first be applied to amounts contributed to defined contribution plans and then to amounts described in this paragraph. If an employer makes an election under this paragraph for a taxable year, paragraph (6) shall not apply to such employer for such taxable year.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2001.

SEC. 654. TREATMENT OF MULTIEMPLOYER PLANS UNDER SECTION 415.

(a) COMPENSATION LIMIT.—

(1) IN GENERAL.—Paragraph (11) of section 415(b) (relating to limitation for defined benefit plans) is amended to read as follows:

"(11) SPECIAL LIMITATION RULE FOR GOVERNMENTAL AND MULTIEMPLOYER PLANS.—In the case of a governmental plan (as defined in section 414(d)) or a multiemployer plan (as defined in section 414(f)), subparagraph (B) of paragraph (1) shall not apply.".

(2) CONFORMING AMENDMENT.—Section 415(b)(7) (relating to benefits under certain collectively bargained plans) is amended by inserting "(other than a multiemployer plan)" after "defined benefit plan" in the matter preceding subparagraph (A).

(b) COMBINING AND AGGREGATION OF PLANS.—

(1) COMBINING OF PLANS.—Subsection (f) of section 415 (relating to combining of plans) is amended by adding at the end the following:

"(3) EXCEPTION FOR MULTIEMPLOYER PLANS.—Notwithstanding paragraph (1) and subsection (g), a multiemployer plan (as defined in section 414(f)) shall not be combined or aggregated—

"(A) with any other plan which is not a multiemployer plan for purposes of applying subsection (b)(1)(B) to such other plan, or

"(B) with any other multiemployer plan for purposes of applying the limitations established in this section.".

(2) CONFORMING AMENDMENT FOR AGGREGATION OF PLANS.—Subsection (g) of section 415 (relating to aggregation of plans) is amended by striking "The Secretary" and inserting "Except as provided in subsection (f)(3), the Secretary".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2001.

SEC. 655. PROTECTION OF INVESTMENT OF EMPLOYEE CONTRIBUTIONS TO 401(k) PLANS.

(a) IN GENERAL.—Section 1524(b) of the Taxpayer Relief Act of 1997 is amended to read as follows:

"(b) EFFECTIVE DATE.—

"(1) IN GENERAL.—Except as provided in paragraph (2), the amendments made by this section shall apply to elective deferrals for plan years beginning after December 31, 1998.

"(2) NONAPPLICATION TO PREVIOUSLY ACQUIRED PROPERTY.—The amendments made by this section shall not apply to any elective deferral which is invested in assets consisting of qualifying employer securities, qualifying employer real property, or both, if such assets were acquired before January 1, 1999.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply as if included in the provision of the Taxpayer Relief Act of 1997 to which it relates.

SEC. 656. PROHIBITED ALLOCATIONS OF STOCK IN S CORPORATION ESOP.

(a) IN GENERAL.—Section 409 (relating to qualifications for tax credit employee stock ownership plans) is amended by redesignating subsection (p) as subsection (q) and by inserting after subsection (o) the following new subsection:

"(p) PROHIBITED ALLOCATIONS OF SECURITIES IN AN S CORPORATION.—

"(1) IN GENERAL.—An employee stock ownership plan holding employer securities consisting of stock in an S corporation shall provide that no portion of the assets of the plan attributable to (or allocable in lieu of) such employer securities may, during a nonallocation year, accrue (or be allocated directly or indirectly under any plan of the employer meeting the requirements of section 401(a)) for the benefit of any disqualified person.

"(2) FAILURE TO MEET REQUIREMENTS.—

"(A) IN GENERAL.—If a plan fails to meet the requirements of paragraph (1), the plan shall be treated as having distributed to any disqualified person the amount allocated to the account of such person in violation of paragraph (1) at the time of such allocation.

"(B) CROSS REFERENCE.—

"For excise tax relating to violations of paragraph (1) and ownership of synthetic equity, see section 4979A.

"(3) NONALLOCATION YEAR.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'nonallocation year' means any plan year of an employee stock ownership plan if, at any time during such plan year—

"(i) such plan holds employer securities consisting of stock in an S corporation, and

"(ii) disqualified persons own at least 50 percent of the number of shares of stock in the S corporation.

"(B) ATTRIBUTION RULES.—For purposes of subparagraph (A)—

"(i) IN GENERAL.—The rules of section 318(a) shall apply for purposes of determining ownership, except that—

"(I) in applying paragraph (1) thereof, the members of an individual's family shall include members of the family described in paragraph (4)(D), and

"(II) paragraph (4) thereof shall not apply.

"(ii) DEEMED-OWNED SHARES.—Notwithstanding the employee trust exception in section 318(a)(2)(B)(i),

an individual shall be treated as owning deemed-owned shares of the individual.

Solely for purposes of applying paragraph (5), this subparagraph shall be applied after the attribution rules of paragraph (5) have been applied.

"(4) DISQUALIFIED PERSON.—For purposes of this subsection—

"(A) IN GENERAL.—The term 'disqualified person' means any person if—

"(i) the aggregate number of deemed-owned shares of such person and the members of such person's family is at least 20 percent of the number of deemed-owned shares of stock in the S corporation, or

"(ii) in the case of a person not described in clause (i), the number of deemed-owned shares of such person is at least 10 percent of the number of deemed-owned shares of stock in such corporation.

"(B) TREATMENT OF FAMILY MEMBERS.—In the case of a disqualified person described in subparagraph (A)(i), any member of such person's family with deemed-owned shares shall be treated as a disqualified person if not otherwise treated as a disqualified person under subparagraph (A).

"(C) DEEMED-OWNED SHARES.—

"(i) IN GENERAL.—The term 'deemed-owned shares' means, with respect to any person—

"(I) the stock in the S corporation constituting employer securities of an employee stock ownership plan which is allocated to such person under the plan, and

"(II) such person's share of the stock in such corporation which is held by such plan but which is not allocated under the plan to participants.

"(ii) PERSON'S SHARE OF UNALLOCATED STOCK.—For purposes of clause (i)(II), a person's share of unallocated S corporation stock held by such plan is the amount of the unallocated stock which would be allocated to such person if the unallocated stock were allocated to all participants in the same proportions as the most recent stock allocation under the plan.

"(D) MEMBER OF FAMILY.—For purposes of this paragraph, the term 'member of the family' means, with respect to any individual—

"(i) the spouse of the individual,

"(ii) an ancestor or lineal descendant of the individual or the individual's spouse,

"(iii) a brother or sister of the individual or the individual's spouse and any lineal descendant of the brother or sister, and

"(iv) the spouse of any individual described in clause (ii) or (iii).

A spouse of an individual who is legally separated from such individual under a decree of divorce or separate maintenance shall not be treated as such individual's spouse for purposes of this subparagraph.

"(5) TREATMENT OF SYNTHETIC EQUITY.—For purposes of paragraphs (3) and (4), in the case of a person who owns synthetic equity in the S corporation, except to the extent provided in regulations, the shares of stock in such corporation on which such synthetic equity is based shall be treated as outstanding stock in such corporation and deemed-owned shares of such person if such treatment of synthetic equity of 1 or more such persons results in—

"(A) the treatment of any person as a disqualified person, or

"(B) the treatment of any year as a nonallocation year.

For purposes of this paragraph, synthetic equity shall be treated as owned by a person in the same manner as stock is treated as owned by a person under the rules of paragraphs (2) and (3) of section 318(a). If, without regard to this paragraph, a person is treated as a disqualified person or a year is treated as a nonallocation year, this paragraph shall not be construed to result in the person or year not being so treated.

"(6) DEFINITIONS.—For purposes of this subsection—

"(A) EMPLOYEE STOCK OWNERSHIP PLAN.—The term 'employee stock ownership plan' has the meaning given such term by section 4975(e)(7).

"(B) EMPLOYER SECURITIES.—The term 'employer security' has the meaning given such term by section 409(l).

"(C) SYNTHETIC EQUITY.—The term 'synthetic equity' means any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest or right that gives the holder the right to acquire or receive stock of the S corporation in the future. Except to the extent provided in regulations, synthetic equity also includes a stock appreciation right, phantom stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value.

"(7) REGULATIONS AND GUIDANCE.—

"(A) IN GENERAL.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection.

"(B) AVOIDANCE OR EVASION.—The Secretary may, by regulation or other guidance of general applicability, provide that a nonallocation year occurs in any case in which the principal purpose of the ownership structure of an S corporation constitutes an avoidance or evasion of this subsection.".

(b) COORDINATION WITH SECTION 4975(e)(7).—The last sentence of section 4975(e)(7) (defining employee stock ownership plan) is amended by inserting ", section 409(p)," after "409(n)".

(c) EXCISE TAX.—

(1) APPLICATION OF TAX.—Subsection (a) of section 4979A (relating to tax on certain prohibited allocations of employer securities) is amended—

(A) by striking "or" at the end of paragraph (1), and

(B) by striking all that follows paragraph (2) and inserting the following:

"(3) there is any allocation of employer securities which violates the provisions of section 409(p), or a nonallocation year

described in subsection (e)(2)(C) with respect to an employee stock ownership plan, or

"(4) any synthetic equity is owned by a disqualified person in any nonallocation year,

there is hereby imposed a tax on such allocation or ownership equal to 50 percent of the amount involved.".

(2) LIABILITY.—Section 4979A(c) (defining liability for tax) is amended to read as follows:

"(c) LIABILITY FOR TAX.—The tax imposed by this section shall be paid—

"(1) in the case of an allocation referred to in paragraph (1) or (2) of subsection (a), by—

"(A) the employer sponsoring such plan, or

"(B) the eligible worker-owned cooperative,

which made the written statement described in section 664(g)(1)(E) or in section 1042(b)(3)(B) (as the case may be), and

"(2) in the case of an allocation or ownership referred to in paragraph (3) or (4) of subsection (a), by the S corporation the stock in which was so allocated or owned.".

(3) DEFINITIONS.—Section 4979A(e) (relating to definitions) is amended to read as follows:

"(e) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) DEFINITIONS.—Except as provided in paragraph (2), terms used in this section have the same respective meanings as when used in sections 409 and 4978.

"(2) SPECIAL RULES RELATING TO TAX IMPOSED BY REASON OF PARAGRAPH (3) OR (4) OF SUBSECTION (a).—

"(A) PROHIBITED ALLOCATIONS.—The amount involved with respect to any tax imposed by reason of subsection (a)(3) is the amount allocated to the account of any person in violation of section 409(p)(1).

"(B) SYNTHETIC EQUITY.—The amount involved with respect to any tax imposed by reason of subsection (a)(4) is the value of the shares on which the synthetic equity is based.

"(C) SPECIAL RULE DURING FIRST NONALLOCATION YEAR.—For purposes of subparagraph (A), the amount involved for the first nonallocation year of any employee stock ownership plan shall be determined by taking into account the total value of all the deemed-owned shares of all disqualified persons with respect to such plan.

"(D) STATUTE OF LIMITATIONS.—The statutory period for the assessment of any tax imposed by this section by reason of paragraph (3) or (4) of subsection (a) shall not expire before the date which is 3 years from the later of—

"(i) the allocation or ownership referred to in such paragraph giving rise to such tax, or

"(ii) the date on which the Secretary is notified of such allocation or ownership.".

(d) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan years beginning after December 31, 2004.

(2) EXCEPTION FOR CERTAIN PLANS.—In the case of any—

(A) employee stock ownership plan established after March 14, 2001, or

(B) employee stock ownership plan established on or before such date if employer securities held by the plan consist of stock in a corporation with respect to which an election under section 1362(a) of the Internal Revenue Code of 1986 is not in effect on such date,

the amendments made by this section shall apply to plan years ending after March 14, 2001.

SEC. 657. AUTOMATIC ROLLOVERS OF CERTAIN MANDATORY DISTRIBUTIONS.

(a) DIRECT TRANSFERS OF MANDATORY DISTRIBUTIONS.—

(1) IN GENERAL.—Section 401(a)(31) (relating to optional direct transfer of eligible rollover distributions), as amended by section 643, is amended by redesignating subparagraphs (B), (C), and (D) as subparagraphs (C), (D), and (E), respectively, and by inserting after subparagraph (A) the following new subparagraph:

"(B) CERTAIN MANDATORY DISTRIBUTIONS.—

"(i) IN GENERAL.—In case of a trust which is part of an eligible plan, such trust shall not constitute a qualified trust under this section unless the plan of which such trust is a part provides that if—

"(I) a distribution described in clause (ii) in excess of $1,000 is made, and

"(II) the distributee does not make an election under subparagraph (A) and does not elect to receive the distribution directly,

the plan administrator shall make such transfer to an individual retirement plan of a designated trustee or issuer and shall notify the distributee in writing (either separately or as part of the notice under section 402(f)) that the distribution may be transferred to another individual retirement plan.

"(ii) ELIGIBLE PLAN.—For purposes of clause (i), the term 'eligible plan' means a plan which provides that any nonforfeitable accrued benefit for which the present value (as determined under section 411(a)(11)) does not exceed $5,000 shall be immediately distributed to the participant.".

(2) CONFORMING AMENDMENTS.—

(A) The heading of section 401(a)(31) is amended by striking "OPTIONAL DIRECT" and inserting "DIRECT".

(B) Section 401(a)(31)(C), as redesignated by paragraph (1), is amended by striking "Subparagraph (A)" and inserting "Subparagraphs (A) and (B)".

(b) NOTICE REQUIREMENT.—Subparagraph (A) of section 402(f)(1) is amended by inserting before the comma at the end the following: "and that the automatic distribution by direct transfer applies to certain distributions in accordance with section 401(a)(31)(B)".

(c) FIDUCIARY RULES.—

(1) IN GENERAL.—Section 404(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104(c)) is amended by adding at the end the following new paragraph:

"(3) In the case of a pension plan which makes a transfer to an individual retirement account or annuity of a designated trustee or issuer under section 401(a)(31)(B) of the Internal Revenue Code of 1986, the participant or beneficiary shall, for purposes of paragraph (1), be treated as exercising control over the assets in the account or annuity upon—

"(A) the earlier of the earlier of—

"(i) a rollover of all or a portion of the amount to another individual retirement account or annuity; or

"(ii) one year after the transfer is made; or

"(B) if the transfer is made in a manner consistent with guidance provided by the Secretary.".

(2) REGULATIONS.—

(A) AUTOMATIC ROLLOVER SAFE HARBOR.—Not later than 3 years after the date of enactment of this Act, the Secretary of Labor shall prescribe regulations providing for safe harbors under which the designation of an institution and investment of funds in accordance with section 401(a)(31)(B) of the Internal Revenue Code of 1986 is deemed to satisfy the fiduciary requirements of section 404(a) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1104(a)).

(B) USE OF LOW-COST INDIVIDUAL RETIREMENT PLANS.—The Secretary of the Treasury and the Secretary of Labor may provide, and shall give consideration to providing, special relief with respect to the use of low-cost individual retirement plans for purposes of transfers under section 401(a)(31)(B) of the Internal Revenue Code of 1986 and for other uses that promote the preservation of assets for retirement income purposes.

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to distributions made after final regulations implementing subsection (c)(2)(A) are prescribed.

SEC. 658. CLARIFICATION OF TREATMENT OF CONTRIBUTIONS TO MULTIEMPLOYER PLAN.

(a) NOT CONSIDERED METHOD OF ACCOUNTING.—For purposes of section 446 of the Internal Revenue Code of 1986, a determination under section 404(a)(6) of such Code regarding the taxable year with respect to which a contribution to a multiemployer pension plan is deemed made shall not be treated as a method of accounting of the taxpayer. No deduction shall be allowed for any taxable year for any contribution to a multiemployer pension plan with respect to which a deduction was previously allowed.

(b) REGULATIONS.—The Secretary of the Treasury shall promulgate such regulations as necessary to clarify that a taxpayer shall not be allowed an aggregate amount of deductions for contributions to a multiemployer pension plan which exceeds the amount of such contributions made or deemed made under section 404(a)(6) of the Internal Revenue Code of 1986 to such plan.

(c) EFFECTIVE DATE.—Subsection (a), and any regulations promulgated under subsection (b), shall be effective for years ending after the date of the enactment of this Act.

PART II—TREATMENT OF PLAN AMENDMENTS REDUCING FUTURE BENEFIT ACCRUALS

SEC. 659. EXCISE TAX ON FAILURE TO PROVIDE NOTICE BY DEFINED BENEFIT PLANS SIGNIFICANTLY REDUCING FUTURE BENEFIT ACCRUALS.

(a) AMENDMENT OF INTERNAL REVENUE CODE.—

(1) IN GENERAL.—Chapter 43 (relating to qualified pension, etc., plans) is amended by adding at the end the following new section:

"SEC. 4980F. FAILURE OF APPLICABLE PLANS REDUCING BENEFIT ACCRUALS TO SATISFY NOTICE REQUIREMENTS.

"(a) IMPOSITION OF TAX.—There is hereby imposed a tax on the failure of any applicable pension plan to meet the requirements of subsection (e) with respect to any applicable individual.

"(b) AMOUNT OF TAX.—

"(1) IN GENERAL.—The amount of the tax imposed by subsection (a) on any failure with respect to any applicable individual shall be $100 for each day in the noncompliance period with respect to such failure.

"(2) NONCOMPLIANCE PERIOD.—For purposes of this section, the term 'noncompliance period' means, with respect to any failure, the period beginning on the date the failure first occurs and ending on the date the notice to which the failure relates is provided or the failure is otherwise corrected.

"(c) LIMITATIONS ON AMOUNT OF TAX.—

"(1) TAX NOT TO APPLY WHERE FAILURE NOT DISCOVERED AND REASONABLE DILIGENCE EXERCISED.—No tax shall be imposed by subsection (a) on any failure during any period for which it is established to the satisfaction of the Secretary that any person subject to liability for the tax under subsection (d) did not know that the failure existed and exercised reasonable diligence to meet the requirements of subsection (e).

"(2) TAX NOT TO APPLY TO FAILURES CORRECTED WITHIN 30 DAYS.—No tax shall be imposed by subsection (a) on any failure if—

"(A) any person subject to liability for the tax under subsection (d) exercised reasonable diligence to meet the requirements of subsection (e), and

"(B) such person provides the notice described in subsection (e) during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that such failure existed.

"(3) OVERALL LIMITATION FOR UNINTENTIONAL FAILURES.—

"(A) IN GENERAL.—If the person subject to liability for tax under subsection (d) exercised reasonable diligence to meet the requirements of subsection (e), the tax imposed by subsection (a) for failures during the taxable year of the employer (or, in the case of a multiemployer plan, the taxable year of the trust forming part of the plan) shall not exceed $500,000. For purposes of the preceding sentence, all multiemployer plans of which the same trust forms a part shall be treated as 1 plan.

"(B) TAXABLE YEARS IN THE CASE OF CERTAIN CONTROLLED GROUPS.—For purposes of this paragraph, if all

persons who are treated as a single employer for purposes of this section do not have the same taxable year, the taxable years taken into account shall be determined under principles similar to the principles of section 1561.

"(4) WAIVER BY SECRETARY.—In the case of a failure which is due to reasonable cause and not to willful neglect, the Secretary may waive part or all of the tax imposed by subsection (a) to the extent that the payment of such tax would be excessive or otherwise inequitable relative to the failure involved.

"(d) LIABILITY FOR TAX.—The following shall be liable for the tax imposed by subsection (a):

"(1) In the case of a plan other than a multiemployer plan, the employer.

"(2) In the case of a multiemployer plan, the plan.

"(e) NOTICE REQUIREMENTS FOR PLANS SIGNIFICANTLY REDUCING BENEFIT ACCRUALS.—

"(1) IN GENERAL.—If an applicable pension plan is amended to provide for a significant reduction in the rate of future benefit accrual, the plan administrator shall provide written notice to each applicable individual (and to each employee organization representing applicable individuals).

"(2) NOTICE.—The notice required by paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary) to allow applicable individuals to understand the effect of the plan amendment. The Secretary may provide a simplified form of notice for, or exempt from any notice requirement, a plan—

"(A) which has fewer than 100 participants who have accrued a benefit under the plan, or

"(B) which offers participants the option to choose between the new benefit formula and the old benefit formula.

"(3) TIMING OF NOTICE.—Except as provided in regulations, the notice required by paragraph (1) shall be provided within a reasonable time before the effective date of the plan amendment.

"(4) DESIGNEES.—Any notice under paragraph (1) may be provided to a person designated, in writing, by the person to which it would otherwise be provided.

"(5) NOTICE BEFORE ADOPTION OF AMENDMENT.—A plan shall not be treated as failing to meet the requirements of paragraph (1) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.

"(f) DEFINITIONS AND SPECIAL RULES.—For purposes of this section—

"(1) APPLICABLE INDIVIDUAL.—The term 'applicable individual' means, with respect to any plan amendment—

"(A) each participant in the plan, and

"(B) any beneficiary who is an alternate payee (within the meaning of section 414(p)(8)) under an applicable qualified domestic relations order (within the meaning of section 414(p)(1)(A)),

whose rate of future benefit accrual under the plan may reasonably be expected to be significantly reduced by such plan amendment.

"(2) APPLICABLE PENSION PLAN.—The term 'applicable pension plan' means—

"(A) any defined benefit plan, or

"(B) an individual account plan which is subject to the funding standards of section 412.

Such term shall not include a governmental plan (within the meaning of section 414(d)) or a church plan (within the meaning of section 414(e)) with respect to which the election provided by section 410(d) has not been made.

"(3) EARLY RETIREMENT.—A plan amendment which eliminates or significantly reduces any early retirement benefit or retirement-type subsidy (within the meaning of section 411(d)(6)(B)(i)) shall be treated as having the effect of significantly reducing the rate of future benefit accrual.

"(g) NEW TECHNOLOGIES.—The Secretary may by regulations allow any notice under subsection (e) to be provided by using new technologies.".

(2) CLERICAL AMENDMENT.—The table of sections for chapter 43 is amended by adding at the end the following new item:

"Sec. 4980F. Failure of applicable plans reducing benefit accruals to satisfy notice requirements.".

(b) AMENDMENT OF ERISA.—Subsection (h) of section 204 of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1054) is amended to read as follows:

"(h)(1) An applicable pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual unless the plan administrator provides the notice described in paragraph (2) to each applicable individual (and to each employee organization representing applicable individuals).

"(2) The notice required by paragraph (1) shall be written in a manner calculated to be understood by the average plan participant and shall provide sufficient information (as determined in accordance with regulations prescribed by the Secretary of the Treasury) to allow applicable individuals to understand the effect of the plan amendment. The Secretary of the Treasury may provide a simplified form of notice for, or exempt from any notice requirement, a plan—

"(A) which has fewer than 100 participants who have accrued a benefit under the plan, or

"(B) which offers participants the option to choose between the new benefit formula and the old benefit formula.

"(3) Except as provided in regulations prescribed by the Secretary of the Treasury, the notice required by paragraph (1) shall be provided within a reasonable time before the effective date of the plan amendment.

"(4) Any notice under paragraph (1) may be provided to a person designated, in writing, by the person to which it would otherwise be provided.

"(5) A plan shall not be treated as failing to meet the requirements of paragraph (1) merely because notice is provided before the adoption of the plan amendment if no material modification of the amendment occurs before the amendment is adopted.

"(6)(A) In the case of any egregious failure to meet any requirement of this subsection with respect to any plan amendment, the provisions of the applicable pension plan shall be applied as if such plan amendment entitled all applicable individuals to the greater of—

"(i) the benefits to which they would have been entitled without regard to such amendment, or

"(ii) the benefits under the plan with regard to such amendment.

"(B) For purposes of subparagraph (A), there is an egregious failure to meet the requirements of this subsection if such failure is within the control of the plan sponsor and is—

"(i) an intentional failure (including any failure to promptly provide the required notice or information after the plan administrator discovers an unintentional failure to meet the requirements of this subsection),

"(ii) a failure to provide most of the individuals with most of the information they are entitled to receive under this subsection, or

"(iii) a failure which is determined to be egregious under regulations prescribed by the Secretary of the Treasury.

"(7) The Secretary of the Treasury may by regulations allow any notice under this subsection to be provided by using new technologies.

"(8) For purposes of this subsection—

"(A) The term 'applicable individual' means, with respect to any plan amendment—

"(i) each participant in the plan; and

"(ii) any beneficiary who is an alternate payee (within the meaning of section 206(d)(3)(K)) under an applicable qualified domestic relations order (within the meaning of section 206(d)(3)(B)(i)),

whose rate of future benefit accrual under the plan may reasonably be expected to be significantly reduced by such plan amendment.

"(B) The term 'applicable pension plan' means—

"(i) any defined benefit plan; or

"(ii) an individual account plan which is subject to the funding standards of section 412 of the Internal Revenue Code of 1986.

"(9) For purposes of this subsection, a plan amendment which eliminates or significantly reduces any early retirement benefit or retirement-type subsidy (within the meaning of subsection (g)(2)(A)) shall be treated as having the effect of significantly reducing the rate of future benefit accrual.".

(c) EFFECTIVE DATES.—

(1) IN GENERAL.—The amendments made by this section shall apply to plan amendments taking effect on or after the date of the enactment of this Act.

(2) TRANSITION.—Until such time as the Secretary of the Treasury issues regulations under sections 4980F(e)(2) and (3) of the Internal Revenue Code of 1986, and section 204(h) of the Employee Retirement Income Security Act of 1974, as added by the amendments made by this section, a plan shall be treated

as meeting the requirements of such sections if it makes a good faith effort to comply with such requirements.

(3) SPECIAL NOTICE RULE.—

(A) IN GENERAL.—The period for providing any notice required by the amendments made by this section shall not end before the date which is 3 months after the date of the enactment of this Act.

(B) REASONABLE NOTICE.—The amendments made by this section shall not apply to any plan amendment taking effect on or after the date of the enactment of this Act if, before April 25, 2001, notice was provided to participants and beneficiaries adversely affected by the plan amendment (or their representatives) which was reasonably expected to notify them of the nature and effective date of the plan amendment.

Subtitle F—Reducing Regulatory Burdens

SEC. 661. MODIFICATION OF TIMING OF PLAN VALUATIONS.

(a) IN GENERAL.—Paragraph (9) of section 412(c) (relating to annual valuation) is amended to read as follows:

"(9) ANNUAL VALUATION.—

"(A) IN GENERAL.—For purposes of this section, a determination of experience gains and losses and a valuation of the plan's liability shall be made not less frequently than once every year, except that such determination shall be made more frequently to the extent required in particular cases under regulations prescribed by the Secretary.

"(B) VALUATION DATE.—

"(i) CURRENT YEAR.—Except as provided in clause (ii), the valuation referred to in subparagraph (A) shall be made as of a date within the plan year to which the valuation refers or within one month prior to the beginning of such year.

"(ii) USE OF PRIOR YEAR VALUATION.—The valuation referred to in subparagraph (A) may be made as of a date within the plan year prior to the year to which the valuation refers if, as of such date, the value of the assets of the plan are not less than 125 percent of the plan's current liability (as defined in paragraph (7)(B)).

"(iii) ADJUSTMENTS.—Information under clause (ii) shall, in accordance with regulations, be actuarially adjusted to reflect significant differences in participants.".

(b) AMENDMENT OF ERISA.—Paragraph (9) of section 302(c) of the Employee Retirement Income Security Act of 1974 (29 U.S.C. 1053(c)) is amended—

(1) by inserting "(A)" after "(9)", and

(2) by adding at the end the following:

"(B)(i) Except as provided in clause (ii), the valuation referred to in subparagraph (A) shall be made as of a date within the plan year to which the valuation refers or within one month prior to the beginning of such year.

"(ii) The valuation referred to in subparagraph (A) may be made as of a date within the plan year prior to the year to which

the valuation refers if, as of such date, the value of the assets of the plan are not less than 125 percent of the plan's current liability (as defined in paragraph (7)(B)).

"(iii) Information under clause (ii) shall, in accordance with regulations, be actuarially adjusted to reflect significant differences in participants.".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to plan years beginning after December 31, 2001.

SEC. 662. ESOP DIVIDENDS MAY BE REINVESTED WITHOUT LOSS OF DIVIDEND DEDUCTION.

(a) IN GENERAL.—Section 404(k)(2)(A) (defining applicable dividends) is amended by striking "or" at the end of clause (ii), by redesignating clause (iii) as clause (iv), and by inserting after clause (ii) the following new clause:

"(iii) is, at the election of such participants or their beneficiaries—

"(I) payable as provided in clause (i) or (ii), or

"(II) paid to the plan and reinvested in qualifying employer securities, or".

(b) STANDARDS FOR DISALLOWANCE.—Section 404(k)(5)(A) (relating to disallowance of deduction) is amended by inserting "avoidance or" before "evasion".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2001.

SEC. 663. REPEAL OF TRANSITION RULE RELATING TO CERTAIN HIGHLY COMPENSATED EMPLOYEES.

(a) IN GENERAL.—Paragraph (4) of section 1114(c) of the Tax Reform Act of 1986 is hereby repealed.

(b) EFFECTIVE DATE.—The repeal made by subsection (a) shall apply to plan years beginning after December 31, 2001.

SEC. 664. EMPLOYEES OF TAX-EXEMPT ENTITIES.

(a) IN GENERAL.—The Secretary of the Treasury shall modify Treasury Regulations section 1.410(b)–6(g) to provide that employees of an organization described in section 403(b)(1)(A)(i) of the Internal Revenue Code of 1986 who are eligible to make contributions under section 403(b) of such Code pursuant to a salary reduction agreement may be treated as excludable with respect to a plan under section 401(k) or (m) of such Code that is provided under the same general arrangement as a plan under such section 401(k), if—

(1) no employee of an organization described in section 403(b)(1)(A)(i) of such Code is eligible to participate in such section 401(k) plan or section 401(m) plan; and

(2) 95 percent of the employees who are not employees of an organization described in section 403(b)(1)(A)(i) of such Code are eligible to participate in such plan under such section 401(k) or (m).

(b) EFFECTIVE DATE.—The modification required by subsection (a) shall apply as of the same date set forth in section 1426(b) of the Small Business Job Protection Act of 1996.

SEC. 665. CLARIFICATION OF TREATMENT OF EMPLOYER-PROVIDED RETIREMENT ADVICE.

(a) IN GENERAL.—Subsection (a) of section 132 (relating to exclusion from gross income) is amended by striking "or" at the end of paragraph (5), by striking the period at the end of paragraph (6)

and inserting ", or", and by adding at the end the following new paragraph:

"(7) qualified retirement planning services.".

(b) QUALIFIED RETIREMENT PLANNING SERVICES DEFINED.—Section 132 is amended by redesignating subsection (m) as subsection (n) and by inserting after subsection (l) the following:

"(m) QUALIFIED RETIREMENT PLANNING SERVICES.—

"(1) IN GENERAL.—For purposes of this section, the term 'qualified retirement planning services' means any retirement planning advice or information provided to an employee and his spouse by an employer maintaining a qualified employer plan.

"(2) NONDISCRIMINATION RULE.—Subsection (a)(7) shall apply in the case of highly compensated employees only if such services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified employer plan.

"(3) QUALIFIED EMPLOYER PLAN.—For purposes of this subsection, the term 'qualified employer plan' means a plan, contract, pension, or account described in section 219(g)(5).".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to years beginning after December 31, 2001.

SEC. 666. REPEAL OF THE MULTIPLE USE TEST.

(a) IN GENERAL.—Paragraph (9) of section 401(m) is amended to read as follows:

"(9) REGULATIONS.—The Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this subsection and subsection (k), including regulations permitting appropriate aggregation of plans and contributions.".

(b) EFFECTIVE DATE.—The amendment made by this section shall apply to years beginning after December 31, 2001.

Subtitle G—Miscellaneous Provisions

SEC. 671. TAX TREATMENT AND INFORMATION REQUIREMENTS OF ALASKA NATIVE SETTLEMENT TRUSTS.

(a) TREATMENT OF ALASKA NATIVE SETTLEMENT TRUSTS.—Subpart A of part I of subchapter J of chapter 1 (relating to general rules for taxation of trusts and estates) is amended by adding at the end the following new section:

"SEC. 646. TAX TREATMENT OF ELECTING ALASKA NATIVE SETTLEMENT TRUSTS.

"(a) IN GENERAL.—If an election under this section is in effect with respect to any Settlement Trust, the provisions of this section shall apply in determining the income tax treatment of the Settlement Trust and its beneficiaries with respect to the Settlement Trust.

"(b) TAXATION OF INCOME OF TRUST.—Except as provided in subsection (f)(1)(B)(ii)—

"(1) IN GENERAL.—There is hereby imposed on the taxable income of an electing Settlement Trust, other than its net capital gain, a tax at the lowest rate specified in section 1(c).

"(2) CAPITAL GAIN.—In the case of an electing Settlement Trust with a net capital gain for the taxable year, a tax is here-

by imposed on such gain at the rate of tax which would apply to such gain if the taxpayer were subject to a tax on its other taxable income at only the lowest rate specified in section 1(c). Any such tax shall be in lieu of the income tax otherwise imposed by this chapter on such income or gain.

"(c) ONE-TIME ELECTION.—

"(1) IN GENERAL.—A Settlement Trust may elect to have the provisions of this section apply to the trust and its beneficiaries.

"(2) TIME AND METHOD OF ELECTION.—An election under paragraph (1) shall be made by the trustee of such trust—

"(A) on or before the due date (including extensions) for filing the Settlement Trust's return of tax for the first taxable year of such trust ending after the date of the enactment of this section, and

"(B) by attaching to such return of tax a statement specifically providing for such election.

"(3) PERIOD ELECTION IN EFFECT.—Except as provided in subsection (f), an election under this subsection—

"(A) shall apply to the first taxable year described in paragraph (2)(A) and all subsequent taxable years, and

"(B) may not be revoked once it is made.

"(d) CONTRIBUTIONS TO TRUST.—

"(1) BENEFICIARIES OF ELECTING TRUST NOT TAXED ON CONTRIBUTIONS.—In the case of an electing Settlement Trust, no amount shall be includible in the gross income of a beneficiary of such trust by reason of a contribution to such trust.

"(2) EARNINGS AND PROFITS.—The earnings and profits of the sponsoring Native Corporation shall not be reduced on account of any contribution to such Settlement Trust.

"(e) TAX TREATMENT OF DISTRIBUTIONS TO BENEFICIARIES.—Amounts distributed by an electing Settlement Trust during any taxable year shall be considered as having the following characteristics in the hands of the recipient beneficiary:

"(1) First, as amounts excludable from gross income for the taxable year to the extent of the taxable income of such trust for such taxable year (decreased by any income tax paid by the trust with respect to the income) plus any amount excluded from gross income of the trust under section 103.

"(2) Second, as amounts excludable from gross income to the extent of the amount described in paragraph (1) for all taxable years for which an election is in effect under subsection (c) with respect to the trust, and not previously taken into account under paragraph (1).

"(3) Third, as amounts distributed by the sponsoring Native Corporation with respect to its stock (within the meaning of section 301(a)) during such taxable year and taxable to the recipient beneficiary as amounts described in section 301(c)(1), to the extent of current or accumulated earnings and profits of the sponsoring Native Corporation as of the close of such taxable year after proper adjustment is made for all distributions made by the sponsoring Native Corporation during such taxable year.

"(4) Fourth, as amounts distributed by the trust in excess of the distributable net income of such trust for such taxable year.

Amounts distributed to which paragraph (3) applies shall not be treated as a corporate distribution subject to section 311(b), and for purposes of determining the amount of a distribution for purposes of paragraph (3) and the basis to the recipients, section 643(e) and not section 301 (b) or (d) shall apply.

"(f) SPECIAL RULES WHERE TRANSFER RESTRICTIONS MODIFIED.—

"(1) TRANSFER OF BENEFICIAL INTERESTS.—If, at any time, a beneficial interest in an electing Settlement Trust may be disposed of to a person in a manner which would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)) if such interest were Settlement Common Stock—

"(A) no election may be made under subsection (c) with respect to such trust, and

"(B) if such an election is in effect as of such time—

"(i) such election shall cease to apply as of the first day of the taxable year in which such disposition is first permitted,

"(ii) the provisions of this section shall not apply to such trust for such taxable year and all taxable years thereafter, and

"(iii) the distributable net income of such trust shall be increased by the current or accumulated earnings and profits of the sponsoring Native Corporation as of the close of such taxable year after proper adjustment is made for all distributions made by the sponsoring Native Corporation during such taxable year.

In no event shall the increase under clause (iii) exceed the fair market value of the trust's assets as of the date the beneficial interest of the trust first becomes so disposable. The earnings and profits of the sponsoring Native Corporation shall be adjusted as of the last day of such taxable year by the amount of earnings and profits so included in the distributable net income of the trust.

"(2) STOCK IN CORPORATION.—If—

"(A) stock in the sponsoring Native Corporation may be disposed of to a person in a manner which would not be permitted by section 7(h) of the Alaska Native Claims Settlement Act (43 U.S.C. 1606(h)) if such stock were Settlement Common Stock, and

"(B) at any time after such disposition of stock is first permitted, such corporation transfers assets to a Settlement Trust,

paragraph (1)(B) shall be applied to such trust on and after the date of the transfer in the same manner as if the trust permitted dispositions of beneficial interests in the trust in a manner not permitted by such section 7(h).

"(3) CERTAIN DISTRIBUTIONS.—For purposes of this section, the surrender of an interest in a Native Corporation or an electing Settlement Trust in order to accomplish the whole or partial redemption of the interest of a shareholder or beneficiary in such corporation or trust, or to accomplish the whole or partial liquidation of such corporation or trust, shall be deemed to be

a transfer permitted by section 7(h) of the Alaska Native Claims Settlement Act.

"(g) TAXABLE INCOME.—For purposes of this title, the taxable income of an electing Settlement Trust shall be determined under section 641(b) without regard to any deduction under section 651 or 661.

"(h) DEFINITIONS.—For purposes of this section—

"(1) ELECTING SETTLEMENT TRUST.—The term 'electing Settlement Trust' means a Settlement Trust which has made the election, effective for a taxable year, described in subsection (c).

"(2) NATIVE CORPORATION.—The term 'Native Corporation' has the meaning given such term by section 3(m) of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(m)).

"(3) SETTLEMENT COMMON STOCK.—The term 'Settlement Common Stock' has the meaning given such term by section 3(p) of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(p)).

"(4) SETTLEMENT TRUST.—The term 'Settlement Trust' means a trust that constitutes a settlement trust under section 3(t) of the Alaska Native Claims Settlement Act (43 U.S.C. 1602(t)).

"(5) SPONSORING NATIVE CORPORATION.—The term 'sponsoring Native Corporation' means the Native Corporation which transfers assets to an electing Settlement Trust.

"(i) SPECIAL LOSS DISALLOWANCE RULE.—Any loss that would otherwise be recognized by a shareholder upon a disposition of a share of stock of a sponsoring Native Corporation shall be reduced (but not below zero) by the per share loss adjustment factor. The per share loss adjustment factor shall be the aggregate of all contributions to all electing Settlement Trusts sponsored by such Native Corporation made on or after the first day each trust is treated as an electing Settlement Trust expressed on a per share basis and determined as of the day of each such contribution.

"(j) CROSS REFERENCE.—

"For information required with respect to electing Settlement Trusts and sponsoring Native Corporations, see section 6039H.".

(b) REPORTING.—Subpart A of part III of subchapter A of chapter 61 of subtitle F (relating to information concerning persons subject to special provisions) is amended by inserting after section 6039G the following new section:

"SEC. 6039H. INFORMATION WITH RESPECT TO ALASKA NATIVE SETTLEMENT TRUSTS AND SPONSORING NATIVE CORPORATIONS.

"(a) REQUIREMENT.—The fiduciary of an electing Settlement Trust (as defined in section 646(h)(1)) shall include with the return of income of the trust a statement containing the information required under subsection (c).

"(b) APPLICATION WITH OTHER REQUIREMENTS.—The filing of any statement under this section shall be in lieu of the reporting requirements under section 6034A to furnish any statement to a beneficiary regarding amounts distributed to such beneficiary (and such other reporting rules as the Secretary deems appropriate).

"(c) REQUIRED INFORMATION.—The information required under this subsection shall include—

"(1) the amount of distributions made during the taxable year to each beneficiary,

"(2) the treatment of such distribution under the applicable provision of section 646, including the amount that is excludable from the recipient beneficiary's gross income under section 646, and

"(3) the amount (if any) of any distribution during such year that is deemed to have been made by the sponsoring Native Corporation (as defined in section 646(h)(5)).

"(d) SPONSORING NATIVE CORPORATION.—

"(1) IN GENERAL.—The electing Settlement Trust shall, on or before the date on which the statement under subsection (a) is required to be filed, furnish such statement to the sponsoring Native Corporation (as so defined).

"(2) DISTRIBUTEES.—The sponsoring Native Corporation shall furnish each recipient of a distribution described in section 646(e)(3) a statement containing the amount deemed to have been distributed to such recipient by such corporation for the taxable year.".

(c) CLERICAL AMENDMENT.—

(1) The table of sections for subpart A of part I of subchapter J of chapter 1 of such Code is amended by adding at the end the following new item:

"Sec. 646. Tax treatment of electing Alaska Native Settlement Trusts.".

(2) The table of sections for subpart A of part III of subchapter A of chapter 61 of subtitle F of such Code is amended by inserting after the item relating to section 6039G the following new item:

"Sec. 6039H. Information with respect to Alaska Native Settlement Trusts and sponsoring Native Corporations.".

(d) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years ending after the date of the enactment of this Act and to contributions made to electing Settlement Trusts for such year or any subsequent year.

TITLE VII—ALTERNATIVE MINIMUM TAX

SEC. 701. INCREASE IN ALTERNATIVE MINIMUM TAX EXEMPTION.

(a) IN GENERAL.—

(1) Subparagraph (A) of section 55(d)(1) (relating to exemption amount for taxpayers other than corporations) is amended by striking "$45,000" and inserting "$45,000 ($49,000 in the case of taxable years beginning in 2001, 2002, 2003, and 2004)".

(2) Subparagraph (B) of section 55(d)(1) (relating to exemption amount for taxpayers other than corporations) is amended by striking "$33,750" and inserting "$33,750 ($35,750 in the case of taxable years beginning in 2001, 2002, 2003, and 2004)".

(b) CONFORMING AMENDMENTS.—

(1) Paragraph (1) of section 55(d) is amended by striking "and" at the end of subparagraph (B), by striking subparagraph (C), and by inserting after subparagraph (B) the following new subparagraphs:

"(C) 50 percent of the dollar amount applicable under paragraph (1)(A) in the case of a married individual who files a separate return, and

"(D) $22,500 in the case of an estate or trust.".

(2) Subparagraph (C) of section 55(d)(3) is amended by striking "paragraph (1)(C)" and inserting "subparagraph (C) or (D) of paragraph (1)".

(3) The last sentence of section 55(d)(3) is amended—

(A) by striking "paragraph (1)(C)(i)" and inserting "paragraph (1)(C)"; and

(B) by striking "$165,000 or (ii) $22,500" and inserting "the minimum amount of such income (as so determined) for which the exemption amount under paragraph (1)(C) is zero, or (ii) such exemption amount (determined without regard to this paragraph)".

(c) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2000.

TITLE VIII—OTHER PROVISIONS

SEC. 801. TIME FOR PAYMENT OF CORPORATE ESTIMATED TAXES.

Notwithstanding section 6655 of the Internal Revenue Code of 1986—

(1) 100 percent of the amount of any required installment of corporate estimated tax which is otherwise due in September 2001 shall not be due until October 1, 2001; and

(2) 20 percent of the amount of any required installment of corporate estimated tax which is otherwise due in September 2004 shall not be due until October 1, 2004.

SEC. 802. EXPANSION OF AUTHORITY TO POSTPONE CERTAIN TAX-RELATED DEADLINES BY REASON OF PRESIDENTIALLY DECLARED DISASTER.

(a) IN GENERAL.—Section 7508A(a) (relating to authority to postpone certain tax-related deadlines by reason of presidentially declared disaster) is amended by striking "90 days" and inserting "120 days".

(b) EFFECTIVE DATE.—The amendment made by this section shall take effect on the date of enactment of this Act.

SEC. 803. NO FEDERAL INCOME TAX ON RESTITUTION RECEIVED BY VICTIMS OF THE NAZI REGIME OR THEIR HEIRS OR ESTATES.

(a) IN GENERAL.—For purposes of the Internal Revenue Code of 1986, any excludable restitution payments received by an eligible individual (or the individual's heirs or estate) and any excludable interest—

(1) shall not be included in gross income; and

(2) shall not be taken into account for purposes of applying any provision of such Code which takes into account excludable income in computing adjusted gross income, including section 86 of such Code (relating to taxation of Social Security benefits).

For purposes of such Code, the basis of any property received by an eligible individual (or the individual's heirs or estate) as part of an excludable restitution payment shall be the fair market value of such property as of the time of the receipt.

(b) ELIGIBLE INDIVIDUAL.—For purposes of this section, the term "eligible individual" means a person who was persecuted on the basis of race, religion, physical or mental disability, or sexual orientation by Nazi Germany, any other Axis regime, or any other Nazi-controlled or Nazi-allied country.

(c) EXCLUDABLE RESTITUTION PAYMENT.—For purposes of this section, the term "excludable restitution payment" means any payment or distribution to an individual (or the individual's heirs or estate) which—

(1) is payable by reason of the individual's status as an eligible individual, including any amount payable by any foreign country, the United States of America, or any other foreign or domestic entity, or a fund established by any such country or entity, any amount payable as a result of a final resolution of a legal action, and any amount payable under a law providing for payments or restitution of property;

(2) constitutes the direct or indirect return of, or compensation or reparation for, assets stolen or hidden from, or otherwise lost to, the individual before, during, or immediately after World War II by reason of the individual's status as an eligible individual, including any proceeds of insurance under policies issued on eligible individuals by European insurance companies immediately before and during World War II; or

(3) consists of interest which is payable as part of any payment or distribution described in paragraph (1) or (2).

(d) EXCLUDABLE INTEREST.—For purposes of this section, the term "excludable interest" means any interest earned by—

(1) escrow accounts or settlement funds established pursuant to the settlement of the action entitled "In re: Holocaust Victim Assets Litigation," (E.D.N.Y.) C.A. No. 96–4849,

(2) funds to benefit eligible individuals or their heirs created by the International Commission on Holocaust Insurance Claims as a result of the Agreement between the Government of the United States of America and the Government of the Federal Republic of Germany concerning the Foundation "Remembrance, Responsibility, and Future," dated July 17, 2000, or

(3) similar funds subject to the administration of the United States courts created to provide excludable restitution payments to eligible individuals (or eligible individuals' heirs or estates).

(e) EFFECTIVE DATE.—

(1) IN GENERAL.—This section shall apply to any amount received on or after January 1, 2000.

(2) NO INFERENCE.—Nothing in this Act shall be construed to create any inference with respect to the proper tax treatment of any amount received before January 1, 2000.

TITLE IX—COMPLIANCE WITH CONGRESSIONAL BUDGET ACT

SEC. 901. SUNSET OF PROVISIONS OF ACT.

(a) IN GENERAL.—All provisions of, and amendments made by, this Act shall not apply—

(1) to taxable, plan, or limitation years beginning after December 31, 2010, or

(2) in the case of title V, to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010.

(b) APPLICATION OF CERTAIN LAWS.—The Internal Revenue Code of 1986 and the Employee Retirement Income Security Act of 1974 shall be applied and administered to years, estates, gifts, and transfers described in subsection (a) as if the provisions and amendments described in subsection (a) had never been enacted.

And the Senate agree to the same.

WILLIAM THOMAS,
DICK ARMEY,
Managers on the Part of the House.

CHUCK GRASSLEY,
ORRIN HATCH,
FRANK H. MURKOWSKI,
DON NICKLES,
PHIL GRAMM,
MAX BAUCUS,
JOHN BREAUX,
Managers on the Part of the Senate.

JOINT EXPLANATORY STATEMENT OF THE COMMITTEE OF CONFERENCE

The managers on the part of the House and the Senate at the conference on the disagreeing votes of the two Houses on the amendment of the Senate to the bill (H.R. 1836), to provide for reconciliation pursuant to section 104 of the concurrent resolution on the budget for fiscal year 2002, submit the following joint statement to the House and the Senate in explanation of the effect of the action agreed upon by the managers and recommended in the accompanying conference report:

The Senate amendment struck all of the House bill after the enacting clause and inserted a substitute text.

The House recedes from its disagreement to the amendment of the Senate with an amendment that is a substitute for the House bill and the Senate amendment. The differences between the House bill, the Senate amendment, and the substitute agreed to in conference are noted below, except for clerical corrections, conforming changes made necessary by agreements reached by the conferees, and minor drafting and clerical changes.

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I. MARGINAL TAX RATE REDUCTION

A. Individual Income Tax Rate Structure (Secs. 2 and 3 of the House bill, Sec. 101 of the Senate Amendment and Sec. 1 of the Code)

PRESENT LAW

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

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

Regular income tax liability

Regular income tax liability is determined by applying the regular income tax rate schedules (or tax tables) to the individual's taxable income. This tax liability is then reduced by any applicable tax credits. The regular income tax rate schedules are divided into several ranges of income, known as income brackets, and the marginal tax rate increases as the individual's income increases. The

income bracket amounts are adjusted annually for inflation. Separate rate schedules apply based on filing status: single individuals (other than heads of households and surviving spouses), heads of households, married individuals filing joint returns (including surviving spouses), married individuals filing separate returns, and estates and trusts. Lower rates may apply to capital gains.

For 2001, the regular income tax rate schedules for individuals are shown in Table 1, below. The rate bracket breakpoints for married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

TABLE 1.—INDIVIDUAL REGULAR INCOME TAX RATES FOR 2001

If taxable income is over:	But not over:	Then regular income tax equals:
		Single individuals
$0	$27,050	15% of taxable income
$27,050	$65,550	$4,057.50, plus 28% of the amount over $27,050
$65,550	$136,750	$14,837.50, plus 31% of the amount over $65,550
$136,750	$297,350	$36,909.50, plus 36% of the amount over $136,750
Over $297,350		$94,725.50, plus 39.6% of the amount over $297,350
		Heads of households
$0	$36,250	15% of taxable income
$36,250	$93,650	$5,437.50, plus 28% of the amount over $36,250
$93,650	$151,650	$21,509.50, plus 31% of the amount over $93,650
$151,650	$297,350	$39,489.50, plus 36% of the amount over $151,650
Over $297,350		$91,941.50, plus 39.6% of the amount over $297,350
		Married individuals filing joint returns
$0	$45,200	15% of taxable income
$45,200	$109,250	$6,780.00, plus 28% of the amount over $45,200
$109,250	$166,500	$24,714.50, plus 31% of the amount over $109,250
$166,500	$297,350	$42,461.50, plus 36% of the amount over $166,500
Over $297,350		$89,567.50, plus 39.6% of the amount over $297,350

HOUSE BILL

In general

The House bill creates a new low-rate regular income tax bracket for a portion of taxable income that is currently taxed at 15 percent. The bill reduces the other regular income tax rates and consolidates rate brackets. By 2006, the present-law structure of five regular income tax rates (15 percent, 28 percent, 31 percent, 36 percent and 39.6 percent) will be reduced to four rates of 10 percent, 15 percent, 25 percent, and 33 percent.

New low-rate bracket

The bill establishes a new regular income tax rate bracket for a portion of taxable income that is currently taxed at 15 percent, as shown in Table 2, below. The taxable income levels for the new low-rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2006.

TABLE 2.—PROPOSED NEW LOW-RATE BRACKET

Calendar Year	Taxable income			Proposed new rate
	Single individuals	Heads of household	Married filing joint returns	
2001–2002	0–$6,000	0–$10,000	0–$12,000	12%
2003–2005	0–$6,000	0–$10,000	0–$12,000	11%
2006	0–$6,000	0–$10,000	0–$12,000	10%
2007 and later	Adjust annually for inflation [1]			10%

[1] The new low-rate bracket for joint returns and head of household returns will be rounded down to the nearest $50. The bracket for single individuals and married individuals filing separately will be one-half the bracket for joint returns (after adjustment of that bracket for inflation).

Modification of 15-percent bracket

The 15-percent regular income tax bracket is modified to begin at the end of the new low-rate regular income tax bracket. The 15-percent regular income tax bracket ends at the same level as under present law. H.R. 6 also makes other changes to the 15-percent rate bracket.[1]

Reduction of other rates and consolidation of rate brackets

The present-law regular income tax rates of 28 percent and 31 percent are phased down to 25 percent over five years, effective for taxable years beginning after December 31, 2001. The taxable income level for the new 25-percent rate bracket begins at the level at which the 28-percent rate bracket begins under present law and ends at the level at which the 31-percent rate bracket ends under present law.

The present-law regular income tax rates of 36 percent and 39.6 percent are phased down to 33 percent over five years, effective for taxable years beginning after December 31, 2001. The taxable income level for the new 33-percent rate bracket begins at the level at which the 36-percent rate bracket begins under present law.

Table 3, below, shows the schedule of proposed regular income tax rate reductions.

TABLE 3.—PROPOSED REGULAR INCOME TAX RATE REDUCTIONS

Calendar Year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2002	27%	30%	35%	38%
2003	27%	29%	35%	37%
2004	26%	28%	34%	36%
2005	26%	27%	34%	35%
2006 and later	25%	25%	33%	33%

Projected regular income tax rate schedules under the proposal

Table 4, below, shows the projected individual regular income tax rate schedules when the rate reductions are fully phased in (i.e., for 2006). As under present law, the rate brackets for married taxpayers filing separate returns under the bill are one half the rate brackets for married individuals filing joint returns. In addition, appropriate adjustments are made to the separate, compressed rate schedule for estate and trusts.

[1] See discussion of the marriage penalty relief in the 15–percent bracket.

TABLE 4.—INDIVIDUAL REGULAR INCOME TAX RATES FOR 2006 (PROJECTED)

If taxable income is:	Then regular income tax equals:
Single individuals	
$0–6,000	10% of taxable income
$6,000–30,950	$600, plus 15 percent of the amount over $6,000
$30,950–$156,300	$4,342.50, plus 25% of the amount over $30,950
Over $156,300	$35,680, plus 33% of the amount over $156,300
Heads of households	
$0–$10,000	10% of taxable income
$10,000–$41,450	$1,000, plus 15% of the amount over $10,000
$41,450–$173,300	$5,717.50, plus 25% of the amount over $41,450
Over $173,300	$38,680, plus 33% of the amount over $173,300
Married individuals filing joint returns	
$0–$12,000	10% of taxable income
$12,000–$51,700	$1,200, plus 15% of the amount over $12,000
$51,700–$190,300	$7,155, plus 25% of the amount over $51,700
$190,300	$41,805, plus 33% of the amount over $190,300

Revised wage withholding for 2001

Under present law, the Secretary of the Treasury is authorized to prescribe appropriate income tax withholding tables or computational procedures for the withholding of income taxes from wages paid by employers. The Secretary is expected to make appropriate revisions to the wage withholding tables to reflect the proposed rate reduction for calendar year 2001 as expeditiously as possible.

Transfer to Social Security and Medicare trust funds

The House bill provides that the amounts transferred to the Social Security and Medicare trust funds are determined as if the rate reductions in the bill were not enacted. Thus, there will be no reduction in transfers to these funds as a result of the bill.

Effective date.—The provisions of the House bill generally apply to taxable years beginning after December 31, 2000, except that the conforming amendments to certain withholding provisions under the bill are effective for amounts paid more than 60 days after the date of enactment.

SENATE AMENDMENT

In general

The Senate amendment creates a new 10-percent regular income tax bracket for a portion of taxable income that is currently taxed at 15 percent, effective for taxable years beginning after December 31, 2000. The Senate amendment also reduces other regular income tax rates. By 2007, the present-law individual income tax rates of 28 percent, 31 percent, 36 percent and 39.6 percent will be lowered to 25 percent, 28 percent, 33 percent, and 36 percent, respectively.

New low-rate bracket

The Senate amendment establishes a new 10-percent regular income tax rate bracket for a portion of taxable income that is currently taxed at 15 percent, as shown in Table 3, below. The taxable income levels for the new 10-percent rate bracket will be adjusted

annually for inflation for taxable years beginning after December 31, 2006. The new low-rate bracket for joint returns and head of household returns will be rounded down to the nearest $50. The bracket for single individuals and married individuals filing separately will be one-half the bracket for joint returns (after adjustment for inflation).

The 10-percent rate bracket applies to the first $6,000 of taxable income for single individuals, $10,000 of taxable income for heads of households, and $12,000 for married couples filing joint returns.

Modification of 15-percent bracket

The 15-percent regular income tax bracket is modified to begin at the end of the new low-rate regular income tax bracket. The 15-percent regular income tax bracket ends at the same level as under present law. The Senate amendment also makes other changes to the 15-percent rate bracket.[2]

Reduction of other rates

The present-law regular income tax rates of 28 percent, 31 percent, 36 percent, and 39.6 percent are phased-down over six years to 25 percent, 28 percent, 33 percent, and 36 percent, effective for taxable years beginning after December 31, 2001. The taxable income levels for the new rates are the same as the taxable income levels that apply under the present-law rates.

Table 5, below, shows the schedule of regular income tax rate reductions.

TABLE 5.—REGULAR INCOME TAX RATE REDUCTIONS

Calendar year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2002–2004	27%	30%	35%	38.6%
2005–2006	26%	29%	34%	37.6%
2007 and later	25%	28%	33%	36%

Projected regular income tax rate schedules under the Senate amendment

Table 6, below, shows the projected individual regular income tax rate schedules when the rate reductions are fully phased-in (i.e., for 2007). As under present law, the rate brackets for married taxpayers filing separate returns will be one half the rate brackets for married individuals filing joint returns. In addition, appropriate adjustments will be made to the separate, compressed rate schedule for estate and trusts.

TABLE 6.—INDIVIDUAL REGULAR INCOME TAX RATES FOR 2007 (PROJECTED)

If taxable income is:	But not over:	Then regular income tax equals:
		Single individuals
$0	$6,150	10% of taxable income
$6,150	$31,700	$615, plus 15% of the amount over $6,150
$31,700	$76,800	$4,447.50, plus 25% of the amount over $31,700

[2] See the discussion of marriage penalty relief in sec. 302 of the Senate amendment.

TABLE 6.—INDIVIDUAL REGULAR INCOME TAX RATES FOR 2007 (PROJECTED)—Continued

If taxable income is:	But not over:	Then regular income tax equals:
$76,800	$160,250	$15,722.50 plus 28% of the amount over $76,800
$160,250	$348,350	$39,088.50 plus 33% of the amount over $160,250
Over $348,350		$101,161.50, plus 36% of the amount over $348,350
		Heads of households
$0	$10,250	10% of taxable income
$10,250	$42,500	$1,025, plus 15% of the amount over $10,250
$42,500	$109,700	$5,862.50, plus 25% of the amount over $42,500
$109,700	$177,650	$22,662.50, plus 28% of the amount over $109,700
$177,650	$348,350	$41,688.50, plus 33% of the amount over $177,650
Over $348,350		$98,019.50, plus 36% of the amount over $348,350
		Married individuals filing joint returns
$0	$12,300	10% of taxable income
$12,300	[3]$59,250	$1,230, plus 15% of the amount over $12,300
$59,250	$128,000	$8,272.50, plus 25% of the amount over $59,250
$128,000	$195,050	$25,460, plus 28% of the amount over $128,000
$195,050	$348,350	$44,234, plus 33% of the amount over $195,050
Over $348,350		$94,823, plus 36% of the amount over $348,350

[3] The end point of the 15-percent rate bracket for married individuals filing joint returns also reflects the phase-in of the increase in the size of the 15-percent bracket in section 302 of the Senate amendment.

Revised wage withholding for 2001

Under present law, the Secretary of the Treasury is authorized to prescribe appropriate income tax withholding tables or computational procedures for the withholding of income taxes from wages paid by employers. The Secretary is expected to make appropriate revisions to the wage withholding tables to reflect the rate reduction for calendar year 2001 as expeditiously as possible.

Effective date.—The new 10-percent rate bracket is effective for taxable years beginning after December 31, 2000. The reduction in the 28 percent, 31 percent, 36 percent, and 39.6 percent rates is phased-in beginning in taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

In general

The conference agreement creates a new 10-percent regular income tax bracket for a portion of taxable income that is currently taxed at 15 percent, effective for taxable years beginning after December 31, 2000. The conference agreement also reduces the other regular income tax rates, effective July 1, 2001. By 2006, the present-law regular income tax rates (28 percent, 31 percent, 36 percent and 39.6 percent) will be lowered to 25 percent, 28 percent, 33 percent, and 35 percent, respectively.

New low-rate bracket

The conference agreement establishes a new 10-percent income tax rate bracket for a portion of taxable income that is currently taxed at 15 percent. The 10-percent rate bracket applies to the first $6,000 of taxable income for single individuals, $10,000 of taxable income for heads of households, and $12,000 for married couples filing joint returns. This $6,000 increases to $7,000 and this $12,000 increases to $14,000 for 2008 and thereafter.

The taxable income levels for the new low-rate bracket will be adjusted annually for inflation for taxable years beginning after December 31, 2008. The new low-rate bracket for joint returns and head of household returns will be rounded down to the nearest $50. The bracket for single individuals and married individuals filing separately will be one-half for joint returns (after adjustment of that bracket for inflation).

Rate reduction credit for 2001

The conference agreement includes a rate reduction credit for 2001 to more immediately achieve one of the purposes behind the new bottom rate bracket for 2001 that was included in both the House bill and the Senate amendment. The conferees have chosen to utilize this credit mechanism (and the issuance of checks described below) because it will deliver economic stimulus to the economy more rapidly than would implementation of a new 10-percent rate bracket, even if that were accompanied by an immediate implementation of new wage withholding tables. Accordingly, this rate reduction credit operates in lieu of the new 10-percent income tax rate bracket for 2001.

This credit is computed in the following manner. Taxpayers would be entitled to a credit in tax year 2001 of 5 percent (the difference between the 15-percent rate and the 10-percent rate) of the amount of income that would have been eligible for the new 10-percent rate. Taxpayers may not receive a credit in excess of their income tax liability (determined after nonrefundable credits).

Most taxpayers will receive this credit in the form of a check issued by the Department of the Treasury. The amount of the check would be computed in the same manner as the credit, except that it will be done on the basis of tax returns filed for 2000 (instead of 2001). The conferees anticipate that the Department of the Treasury will make every effort to issue all checks before October 1, 2001, to taxpayers who timely filed their 2000 tax returns. Taxpayers who filed late or pursuant to extensions will receive their checks later in the fall.

Taxpayers would reconcile the amount of the credit with the check they receive in the following manner. They would complete a worksheet calculating the amount of the credit based on their 2001 tax return. They would then subtract from the credit the amount of the check they received. For many taxpayers, these two amounts would be the same. If, however, the result is a positive number (because, for example, the taxpayer paid no tax in 2000 but is paying tax in 2001), the taxpayer may claim that amount as a credit against 2001 tax liability. If, however, the result is negative (because, for example, the taxpayer paid tax in 2000 but owes no tax for 2001), the taxpayer is not required to repay that amount to the Treasury. Otherwise, the checks have no effect on tax returns filed in 2001; the amount is not includible in gross income and it does not otherwise reduce the amount of withholding. In no event may the Department of the Treasury issue checks after December 31, 2001.[4] This is designed to prevent errors by taxpayers

[4] For administrative reasons, the Department of the Treasury may need to establish an earlier termination date in order to fully implement the intent of this provision.

who might claim the full amount of the credit on their 2001 tax returns and file those returns early in 2002, at the same time the Treasury check might be mailed to them. Payment of the credit (or the check) is treated, for all purposes of the Code,[5] as a payment of tax. As such, the credit or the check is subject to the refund offset provisions, such as those applicable to past-due child support under section 6402 of the Code.

In general, taxpayers eligible for the credit (and the check) are individuals other than estates or trusts, nonresident aliens, or dependents. The determination of this status for the relevant year is made on the basis of the information filed on the tax return.

The conferees understand that, in light of the large number of checks that are being issued, the issuance of checks will take several months.[6] Accordingly, no interest will be paid with respect to these checks. The conferees understand that checks will be issued in the order of the last two digits of the taxpayer identification number (which is generally a taxpayer's social security number), from lowest to highest. Payment by check is the only mechanism for receiving the payment prior to filing the 2001 tax return; taxpayers may not file either amended returns or claims for tentative refunds for tax year 2000 to claim these amounts.

The conferees anticipate that the IRS will send notices to most taxpayers approximately one month after enactment. The notices will inform taxpayers of the computation of their checks and the approximate date by which they can expect to receive their check. This information should decrease the number of telephone calls made by taxpayers to the IRS inquiring when their check will be issued.

Modification of 15-percent bracket

The 15-percent regular income tax bracket is modified to begin at the end of the new low-rate regular income tax bracket. The 15-percent regular income tax bracket ends at the same level as under present law. The conference agreement also makes other changes to the 15-percent rate bracket.[7]

Reduction of other rates and consolidation of rate brackets

The present-law regular income tax rates of 28 percent, 31 percent, 36 percent, and 39.6 percent are phased down over six years to 25 percent, 28 percent, 33 percent, and 35 percent, effective after June 30, 2001. Accordingly, for taxable years beginning during 2001, the rate reduction will come in the form of a blended tax rate. The taxable income levels for the new rates in all taxable years are the same as the taxable income levels that apply under the present-law rates.

Table 7, below, shows the schedule of regular income tax rate reductions.

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[5] A special rule provides that no interest will be paid with respect to the checks.

[6] The conferees investigated the possibility of utilizing electronic means, instead of paper checks, to deliver these amounts even more rapidly, but doing so was not possible because of limitations on available data on individual's banking accounts.

[7] See discussion of the conference agreement regarding marriage penalty relief in the 15-percent bracket.

TABLE 7.—REGULAR INCOME TAX RATE REDUCTIONS

Calendar year	28% rate reduced to:	31% rate reduced to:	36% rate reduced to:	39.6% rate reduced to:
2001[1]–2003	27%	30%	35%	38.6%
2004–2005	26%	29%	34%	37.6%
2006 and later	25%	28%	33%	35%

[1] Effective July 1, 2001.

Projected regular income tax rate schedules under the proposal

Table 8, below, shows the projected individual regular income tax rate schedules when the rate reductions are fully phased in (i.e., for 2006). As under present law, the rate brackets for married taxpayers filing separate returns under the bill are one half the rate brackets for married individuals filing joint returns. In addition, appropriate adjustments are made to the separate, compressed rate schedule for estates and trusts.

TABLE 8.—INDIVIDUAL REGULAR INCOME TAX RATES FOR 2006 (PROJECTED)

If taxable income is:	But not over:	Then regular income tax equals:
		Single individuals
$0	$6,000	10% of taxable income
$6,000	$30,950	$600, plus 15% of the amount over $6,000
$30,950	$74,950	$4,342.50, plus 25% of the amount over $30,950
$74,950	$156,300	$15,342.50, plus 28% of the amount over $74,950
$156,300	$339,850	$38,120.50, plus 33% of the amount over $156,300
Over $339,850		$98,692, plus 35% of the amount over $339,850
		Heads of households
$0	$10,000	10% of taxable income
$10,000	$41,450	$1,000, plus 15% of the amount over $10,000
$41,450	$107,000	$5,717.50, plus 25% of the amount over $41,450
$107,000	$173,300	$22,105, plus 28% of the amount over $107,000
$173,300	$339,850	$40,669, plus 33% of the amount over $173,300
Over $339,850		$95,630.50, plus 35% of the amount over $339,850
		Married individuals filing joint returns
$0	$12,000	10% of taxable income
$12,000	[8] $57,850	$1,200, plus 15% of the amount over $12,000
$57,850	$124,900	$8,077.50, plus 25% of the amount over $57,850
$124,900	$190,300	$24,840, plus 28% of the amount over $124,900
$190,300	$339,850	$43,152, plus 33% of the amount over $190,300
Over $339,850		$92,503.50, plus 35% of the amount over $339,850

[8] The end point of the 15-percent rate bracket for married individuals filing joint returns also reflects the phase-in of the increase in the size of the 15-percent bracket in section 302 of the bill, below.

Revised wage withholding for 2001

Under present law, the Secretary of the Treasury is authorized to prescribe appropriate income tax withholding tables or computational procedures for the withholding of income taxes from wages paid by employers. The Secretary is expected to make appropriate revisions to the wage withholding tables to reflect the rate reduction that will be effective beginning July 1, 2001, as expeditiously as possible.

Transfer to Social Security and Medicare trust funds

The conference agreement does not follow the House bill.

Effective date.—The provisions of the conference agreement generally apply to taxable years beginning after December 31, 2000. The reductions in the tax rates, other than the new 10-percent rate, are effective after June 30, 2001. The conforming amendments to certain withholding provisions under the bill are effective for amounts paid more than 60 days after the date of enactment.

B. Increase Starting Point for Phase-Out of Itemized Deductions (Sec. 102 of the Senate Amendment and Sec. 68 of the Code)

PRESENT LAW

Itemized deductions

Taxpayers may choose to claim either the basic standard deduction (and additional standard deductions, if applicable) or itemized deductions (subject to certain limitations) for certain expenses incurred during the taxable year. Among these deductible expenses are 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.

Overall limitation on itemized deductions ("Pease" limitation)

Under present law, the total amount of otherwise allowable itemized deductions (other than medical expenses, investment interest, and casualty, theft, or wagering losses) is reduced by three percent of the amount of the taxpayer's adjusted gross income in excess of $132,950 in 2001 ($66,475 for married couples filing separate returns). These amounts are adjusted annually for inflation. In computing this reduction of total itemized deductions, all present-law limitations applicable to such deductions (such as the separate floors) are first applied and, then, the otherwise allowable total amount of itemized deductions is reduced in accordance with this provision. Under this provision, the otherwise allowable itemized deductions may not be reduced by more than 80 percent.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the starting point of the overall limitation on itemized deductions for all taxpayers (other than married couples filing separate returns) to the starting point of the personal exemption phase-out for married couples filing a joint return. This amount is projected under present law to be $245,500 in 2009. The starting point of the overall limitation on itemized deductions for married couples filing separate returns would continue to be one-half of the amount for other taxpayers.

Effective date.—The provision is effective for taxable years beginning after December 31, 2008.

CONFERENCE AGREEMENT

The conference agreement repeals the overall limitation on itemized deductions for all taxpayers. The repeal is phased-in over five years, as follows. The otherwise applicable overall limitation on itemized deductions is reduced by one-third in taxable years beginning in 2006 and 2007, and by two-thirds in taxable years beginning in 2008 and 2009. The overall limitation is repealed for taxable years beginning after December 31, 2009.

Effective date.—The conference agreement is effective for taxable years beginning after December 31, 2005.

C. Phase-out of Special Rules for Personal Exemptions (Sec. 103 of the Senate Amendment and Sec. 151(d)(3) of the Code)

PRESENT LAW

In order to determine taxable income, an individual reduces adjusted gross income by any personal exemptions, 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. For 2001, the amount deductible for each personal exemption is $2,900. This amount is adjusted annually for inflation.

Under present law, the deduction for personal exemptions is phased-out ratably for taxpayers with adjusted gross income over certain thresholds. The applicable thresholds for 2001 are $132,950 for single individuals, $199,450 for married individuals filing a joint return, $166,200 for heads of households, and $99,725 for married individuals filing separate returns. These thresholds are adjusted annually for inflation.

The total amount of exemptions that may be claimed by a taxpayer is reduced by two percent for each $2,500 (or portion thereof) by which the taxpayer's adjusted gross income exceeds the applicable threshold. The phase-out rate is two percent for each $1,250 for married taxpayers filing separate returns. Thus, the personal exemptions claimed are phased-out over a $122,500 range ($61,250 for married taxpayers filing separate returns), beginning at the applicable threshold. The size of these phase-out ranges ($122,500/$61,250) is not adjusted for inflation. For 2001, the point at which a taxpayer's personal exemptions are completely phased-out is $255,450 for single individuals, $321,950 for married individuals filing a joint return, $288,700 for heads of households, and $160,975 for married individuals filing separate returns.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment repeals the personal exemption phase-out.

Effective date.—The provision is effective for taxable years beginning after December 31, 2008.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with a modification. The modification provides for a five-year phase-in of the repeal of the personal exemption phase-out. Under the five-year phase-in, the otherwise applicable personal exemption phase-out is reduced by one-third in taxable years beginning in 2006 and 2007, and is reduced by two-thirds in taxable years beginning in 2008 and 2009. The repeal is fully effective for taxable years beginning after December 31, 2009.

II. TAX BENEFITS RELATING TO CHILDREN

A. Increase and Expand the Child Tax Credit (sec. 2 of the House Bill, Secs. 201 and 204 of the Senate Amendment and Sec. 24 of the Code)

PRESENT LAW

In general

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

The child tax credit is phased-out for individuals with income over certain thresholds. Specifically, the otherwise allowable child tax credit is reduced by $50 for each $1,000 (or fraction thereof) of modified adjusted gross income over $75,000 for single individuals or heads of households, $110,000 for married individuals filing joint returns, and $55,000 for married individuals filing separate returns. Modified adjusted gross income is the taxpayer's total gross income plus certain amounts excluded from gross income (i.e., excluded income of U.S. citizens or residents living abroad (sec. 911); residents of Guam, American Samoa, and the Northern Mariana Islands (sec. 931); and residents of Puerto Rico (sec. 933)). The length of the phase-out range depends on the number of qualifying children. For example, the phase-out range for a single individual with one qualifying child is between $75,000 and $85,000 of modified adjusted gross income. The phase-out range for a single individual with two qualifying children is between $75,000 and $95,000.

The child tax credit is not adjusted annually for inflation.

Refundability

In general, the child tax credit is nonrefundable. However, for families with three or more qualifying children, the child tax credit is refundable up to the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit.

Alternative minimum tax liability

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

is known as the alternative minimum tax offset of refundable credits.

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

HOUSE BILL

In general

No provision. However, H.R. 6, as passed by the House, contains a provision that increases the child tax credit to $1,000, phased in over six years, beginning in 2001. Table 10, below, shows the proposed increase in the amount of the child tax credit under the provision.

Table 10.—Increase of the Child Tax Credit

Taxable year	*Credit amount per child*
2001	$600
2002	$600
2003	$700
2004	$800
2005	$900
2006 and thereafter	$1,000

Refundability

No provision. However, H.R. 6 extends the present-law refundability of the child tax credit to families with fewer than three children.

Alternative minimum tax

No provision. However, H.R. 6 provides that the refundable child tax credit will no longer be reduced by the amount of the alternative minimum tax. In addition, H.R. 6 allows the child tax credit to the extent of the full amount of the individual's regular income tax and alternative minimum tax.

Effective date.—No provision. However, the provisions of H.R. 6 generally are effective for taxable years beginning after December 31, 2000.

SENATE AMENDMENT

In general

The Senate amendment increases the child tax credit to $1,000, phased-in over eleven years, effective for taxable years beginning after December 31, 2000.

Table 11, below, shows the increase of the child tax credit.

Table 11.—Increase of the Child Tax Credit

Calendar year	*Credit amount per child*
2001–2003	$600
2004–2006	$700
2007–2009	$800

Table 11.—Increase of the Child Tax Credit—Continued

Calendar year	*Credit amount per child*
2010	$900
2011 and later	$1,000

Refundability

The Senate amendment makes the child credit refundable to the extent of 15 percent of the taxpayer's earned income in excess of $10,000.[9] Thus, in 2001, families with earned income of at least $14,000 and one child will get a refundable credit of $600. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (the present-law rule), if that amount is greater than 15 percent of the taxpayer's earned income in excess of $10,000. The Senate amendment also provides that the refundable portion of the child 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.

Alternative minimum tax

Same as H.R. 6.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000.

CONFERENCE AGREEMENT

In general

The conference agreement increases the child tax credit to $1,000, phased-in over ten years, effective for taxable years beginning after December 31, 2000.

Table 12, below, shows the increase of the child tax credit.

Table 12.—Increase of the Child Tax Credit

Calendar year	*Credit amount per child*
2001–2004	$600
2005–2008	$700
2009	$800
2010 and later	$1,000

Refundability

The conference agreement makes the child credit refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for calendar years 2001–2004. The percentage is increased to 15 percent for calendar years 2005 and thereafter. The $10,000 amount is indexed for inflation beginning in 2002. Families with three or more children are allowed a refundable credit for the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income credit (the present-law rule), if that amount is greater than the refundable credit based on the taxpayer's earned income in excess of $10,000. The conference agreement also provides that the refundable portion of the child credit

[9] For these purposes, earned income is defined as under section 32, as amended by this bill.

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.

Alternative minimum tax

The conference agreement follows H.R. 6 and the Senate amendment.

Effective date.—The provision generally is effective for taxable years beginning after December 31, 2000. The provision relating to allowing the child tax credit against alternative minimum tax is effective for taxable years beginning after December 31, 2001.

B. Sense of the Senate Regarding Child Credit Expansion (Sec. 202 of the Senate Amendment)

PRESENT LAW

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

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a Sense of the Senate resolution that the expansion of the child credit included in the Senate amendment be retained in the conference agreement.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment.

C. Extension and Expansion of Adoption Tax Benefits (Sec. 2 of H.R. 622, Sec. 203 of the Senate Amendment, and Secs. 23 and 137 of the Code)

PRESENT LAW

Tax credit

In general

A tax credit is allowed for qualified adoption expenses paid or incurred by a taxpayer. The maximum credit is $5,000 per eligible child ($6,000 for a special needs child). An eligible child is an individual (1) who has not attained age 18 or (2) is physically or mentally incapable of caring for himself or herself. A special needs child is an eligible child who is a citizen or resident of the United States who a 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 (such as the child's ethnic background, age, or member-

ship in a minority or sibling group, or the presence of factors such as medical conditions, or physical, mental, or emotional handicaps) because of which the child cannot be placed with adoptive parents without adoption assistance.

Qualified adoption expenses are reasonable and necessary adoption fees, court costs, attorneys fees, and other expenses that are: (1) directly related to, and the principal purpose of which is for, the legal adoption of an eligible child by the taxpayer; (2) not incurred in violation of State or Federal law, or in carrying out any surrogate parenting arrangement; (3) not for the adoption of the child of the taxpayer's spouse; and (4) not reimbursed (e.g., by an employer).

Qualified adoption expenses may be incurred in one or more taxable years, but the credit may not exceed $5,000 per adoption ($6,000 for a special needs child). The adoption credit is phased out ratably for taxpayers with modified adjusted gross income between $75,000 and $115,000. Modified adjusted gross income is the sum of the taxpayer's adjusted gross income plus amounts excluded from income under Code sections 911, 931, and 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).

The adoption credit for special needs children is permanent. The adoption credit with respect to other children does not apply to expenses paid or incurred after December 31, 2001.

Alternative minimum tax

Through 2001, the adoption credit generally reduces the individual's regular income tax and alternative minimum tax. For taxable years beginning after December 31, 2001, the otherwise allowable adoption credit is 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.

Exclusion from income

A maximum $5,000 exclusion from the gross income of an employee is allowed for qualified adoption expenses paid or reimbursed by an employer under an adoption assistance program. The maximum excludible amount is $6,000 for special needs adoptions. The exclusion is phased out ratably for taxpayers with modified adjusted gross income between $75,000 and $115,000. Modified adjusted gross income is the sum of the taxpayer's adjusted gross income plus amounts excluded from income under Code sections 911, 931, and 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 purposes of this exclusion, modified adjusted gross income also includes all employer payments and reimbursements for adoption expenses whether or not they are taxable to the employee. The exclusion does not apply for purposes of payroll taxes. Adoption expenses paid or reimbursed by the employer under an adoption assistance program are not eligible for the adoption credit. A taxpayer may be eligible for the adoption credit (with

respect to qualified adoption expenses he or she incurs) and also for the exclusion (with respect to different qualified adoption expenses paid or reimbursed by his or her employer).

The exclusion from income does not apply to amounts paid or expenses incurred after December 31, 2001.

HOUSE BILL

Tax credit

No provision. However, H.R. 622, the "Hope for Children Act," as passed by the House, permanently extends the adoption credit for children other than special needs children. The maximum credit is increased to $10,000 per eligible child, including special needs children. The beginning point of the income phase-out range is increased to $150,000 of modified adjusted gross income. Therefore, the adoption credit is phased-out for taxpayers with modified adjusted gross income of $190,000 or more. Finally, the adoption credit is allowed against the alternative minimum tax permanently.

Exclusion from income

No provision. However, H.R. 622 permanently extends the exclusion from income for employer-provided adoption assistance. The maximum exclusion is increased to $10,000 per eligible child, including special needs children. The beginning point of the income phase-out range is increased to $150,000 of modified adjusted gross income. Therefore, the exclusion is not available to taxpayers with modified adjusted gross income of $190,000 or more.

Effective date.—Generally, the provision of H.R. 622 is effective for taxable years beginning after December 31, 2001. Qualified expenses paid or incurred in taxable years beginning on or before December 31, 2001, remain subject to the present-law dollar limits.

SENATE AMENDMENT

Tax credit

Same as H.R. 622, with one modification. The Senate amendment provides a $10,000 credit in the year a special needs adoption is finalized regardless of whether the taxpayer has qualified adoption expenses. No credit is allowed with respect to the adoption of a special needs child if the adoption is not finalized.

Exclusion from income

Same as H.R. 622, with one modification. The Senate amendment provides a $10,000 exclusion in the case of a special needs adoption regardless of whether the taxpayer has qualified adoption expenses.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with one modification. The provisions of the Senate amendment that extend the tax credit and exclusion from income for special needs adoptions regardless of whether the taxpayer has qualified adop-

tion expenses are effective for taxable years beginning after December 31, 2002.

D. Expansion of Dependent Care Tax Credit (sec. 205 of the Senate amendment and sec. 21 of the Code)

PRESENT LAW

Dependent care tax credit

A taxpayer who maintains a household that includes one or more qualifying individuals may claim a nonrefundable credit against income tax liability for up to 30 percent of a limited amount of employment-related expenses. Eligible employment-related expenses are limited to $2,400 if there is one qualifying individual or $4,800 if there are two or more qualifying individuals. Thus, the maximum credit is $720 if there is one qualifying individual and $1,440 if there are two or more qualifying individuals. The applicable dollar limit ($2,400/$4,800) of otherwise eligible employment-related expenses is reduced by any amount excluded from income under an employer-provided dependent care assistance program. For example, a taxpayer with one qualifying individual who has $2,400 of otherwise eligible employment-related expenses but who excludes $1,000 of dependent care assistance must reduce the dollar limit of eligible employment-related expenses for the dependent care tax credit by the amount of the exclusion to $1,400 ($2,400 − $1,000 = $1,400).

A qualifying individual is (1) a dependent of the taxpayer under the age of 13 for whom the taxpayer is eligible to claim a dependency exemption, (2) a dependent of the taxpayer who is physically or mentally incapable of caring for himself or herself, or (3) the spouse of the taxpayer; if the spouse is physically or mentally incapable of caring for himself or herself.

The 30 percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income above $10,000. The credit is not available to married taxpayers unless they file a joint return.

Exclusion for employer-provided dependent care

Amounts paid or incurred by an employer for dependent care assistance provided to an employee generally are excluded from the employee's gross income and wages if the assistance is furnished under a program meeting certain requirements. These requirements include that the program be described in writing, satisfy certain nondiscrimination rules, and provide for notification to all eligible employees. Dependent care assistance expenses eligible for the exclusion are defined the same as employment-related expenses with respect to a qualifying individual under the dependent care tax credit.

The dependent care exclusion is limited to $5,000 per year, except that a married taxpayer filing a separate return may exclude only $2,500. Dependent care expenses excluded from income are not eligible for the dependent care tax credit (sec. 21(c)).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the maximum amount of eligible employment-related expenses from $2,400 to $3,000, if there is one qualifying individual (from $4,800 to $6,000, if there are two or more qualifying individuals). The Senate amendment also increases the maximum credit from 30 percent to 40 percent. Thus, the maximum credit is $1,200, if there is one qualifying individual and $2,400, if there are two or more qualifying individuals. Finally, the Senate amendment modifies the phase-down of the credit. Under the Senate amendment, the 40-percent credit rate is reduced, but not below 20 percent, by 1 percentage point for each $2,000 (or fraction thereof) of adjusted gross income above $20,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with adjusted gross income over $58,000.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. Under the conference agreement, the maximum credit is 35 percent. Further, the conference agreement provides that the phase-down of the credit applies with respect to adjusted gross income above $15,000. Therefore, the credit percentage is reduced to 20 percent for taxpayers with adjusted gross income over $43,000.

Effective date.—The conference agreement provision is effective for taxable years beginning after December 31, 2002.

E. Tax Credit for Employer-Provided Child Care Facilities (Secs. 206 and 207 of the Senate Amendment and New Sec. 45D of the Code)

PRESENT LAW

Present law does not provide a tax credit to employers for supporting child care or child care resource and referral services. An employer, however, may be able to deduct such expenses as ordinary and necessary business expenses. Alternatively, the employer may be required to capitalize the expenses and claim depreciation deductions over time.

HOUSE BILL

No provision.

SENATE AMENDMENT

Under the Senate amendment, 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;[10] (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); 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).

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 ten-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. Other rules apply.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

[10] In addition, a depreciation deduction (or amortization in lieu of depreciation) must be allowable with respect to the property and the property must not be part of the principal residence of the taxpayer or any employee of the taxpayer.

III. MARRIAGE PENALTY RELIEF PROVISIONS

A. STANDARD DEDUCTION MARRIAGE PENALTY RELIEF (SEC. 2 OF H.R. 6, SEC. 301 OF THE SENATE AMENDMENT AND SEC. 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

Taxpayers who do not itemize deductions may choose the basic standard deduction (and additional standard deductions, if applicable),[11] which is subtracted from adjusted gross income ("AGI") in arriving at taxable income. The size of the basic standard deduction varies according to filing status and is adjusted annually for inflation. For 2001, the basic standard deduction amount for single filers is 60 percent of the basic standard deduction amount for married couples filing joint returns. Thus, two unmarried individuals have standard deductions whose sum exceeds the standard deduction for a married couple filing a joint return.

HOUSE BILL

No provision. However, H.R. 6, as passed by the House, contains a provision that 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. The basic standard deduction for a married taxpayer filing separately will continue to equal one-half of the basic standard deduction for a married couple filing jointly; thus, the basic standard deduction for unmarried individuals filing a single return and for married couples filing separately will be the same.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as H.R. 6 except that the increase in the standard deduction is phased-in over five years beginning in 2005 and would be fully phased-in for 2009 and there-

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

after. Table 13, below, shows the standard deduction for married couples filing a joint return as a percentage of the standard deduction for single individuals during the phase-in period.

Table 13.—Phase-In of Increase of Standard Deduction for Married Couples Filing Joint Returns

Calendar Year	*Standard Deduction for Joint Returns as Percentage of Standard Deduction for Single Returns*
2005	174%
2006	184%
2007	187%
2008	190%
2009 and later	200%

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

B. Expansion of the 15-Percent Rate Bracket for Married Couples Filing Joint Returns (Sec. 3 of H.R. 6, Sec. 302 of the Senate Amendment and Sec. 1 of the Code)

PRESENT LAW

In general

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

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

Regular income tax liability

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

In general, the bracket breakpoints for single individuals are approximately 60 percent of the rate bracket breakpoints for married couples filing joint returns.[12] The rate bracket breakpoints for

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

married individuals filing separate returns are exactly one-half of the rate brackets for married individuals filing joint returns. A separate, compressed rate schedule applies to estates and trusts.

HOUSE BILL

No provision. However, H.R. 6, as passed by the House, contains a provision that increases the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the size of the corresponding rate bracket for an unmarried individual filing a single return. This increase is phased in over six years as shown in Table 15, below. Therefore, this provision is fully effective (i.e., the size of the lowest regular income tax rate bracket for a married couple filing a joint return is twice the size of the lowest regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2008.

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

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

Effective date.—The provision is effective for taxable years beginning after December 31, 2003.

SENATE AMENDMENT

The Senate amendment increases 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. The increase is phased-in over five years, beginning in 2005. Therefore, this provision is fully effective (i.e., the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return would be twice the size of the 15-percent regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2008. Table 16, below, shows the increase in the size of the 15-percent bracket during the phase-in period.

Table 16.—Increase in Size of 15-Percent Rate Bracket for Married Couples Filing a Joint Return

Taxable year	*End point of 15-percent rate bracket for married couple filing joint return as percentage of end point of 15-percent rate bracket for unmarried individuals*
2005	174%
2006	184%
2007	187%
2008	190%
2009 and thereafter	200%

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

CONFERENCE AGREEMENT

The conference agreement increases 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. The increase is phased-in over four years, beginning in 2005. Therefore, this provision is fully effective (i.e., the size of the 15-percent regular income tax rate bracket for a married couple filing a joint return would be twice the size of the 15-percent regular income tax rate bracket for an unmarried individual filing a single return) for taxable years beginning after December 31, 2007. Table 17, below, shows the increase in the size of the 15-percent bracket during the phase-in period.

Table 17.—Increase in Size of 15-Percent Rate Bracket for Married Couples Filing a Joint Return

Taxable year	*End point of 15-percent rate bracket for married couple filing joint return as percentage of end point of 15-percent rate bracket for unmarried individuals*
2005	180%
2006	187%
2007	193%
2008 and thereafter	200%

Effective date.—The provision is effective for taxable years beginning after December 31, 2004.

C. Marriage Penalty Relief and Simplification Relating to the Earned Income Credit (Sec. 2(b)(2) of the House bill, Sec. 4 of H.R. 6, Sec. 303 of the Senate Amendment, and Sec. 32 of the Code)

PRESENT LAW

In general

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

The earned income credit is not available to married individuals who file separate returns. No earned income credit is allowed if the taxpayer has disqualified income in excess of $2,450 (for 2001) for the taxable year.[13] In addition, no earned income credit is allowed if an eligible individual is the qualifying child of another taxpayer.[14]

[13] Sec. 32(i). Disqualified income is the sum of: (1) interest and dividends includible in gross income for the taxable year; (2) tax-exempt income received or accrued in the taxable year; (3) net income from rents and royalties for the taxable year not derived in the ordinary course of business; (4) capital gain net income for the taxpayer year; and (5) net passive income for the taxable year. Sec. 32(i)(2).

[14] Sec. 32(c)(1)(B).

Definition of qualifying child and tie-breaker rules

To claim the earned income credit, a taxpayer must either (1) have a qualifying child or (2) meet the requirements for childless adults. A qualifying child must meet a relationship test, an age test, and a residence test. First, the qualifying child must be the taxpayer's child, stepchild, adopted child, grandchild, or foster child. Second, the child must be under age 19 (or under age 24 if a full-time student) or permanently and totally disabled regardless of age. Third, the child must live with the taxpayer in the United States for more than half the year (a full year for foster children).

An individual satisfies the relationship test under the earned income credit if the individual is the taxpayer's: (1) son or daughter or a descendant of either;[15] (2) stepson or stepdaughter; or (3) eligible foster child. An eligible foster child is an individual (1) who is a brother, sister, stepbrother, or stepsister of the taxpayer (or a descendant of any such relative), or who is placed with the taxpayer by an authorized placement agency, and (2) who the taxpayer cares for as her or his own child. A married child of the taxpayer is not treated as meeting the relationship test unless the taxpayer is entitled to a dependency exemption with respect to the married child (e.g., the support test is satisfied) or would be entitled to the exemption if the taxpayer had not waived the exemption to the noncustodial parent.[16]

If a child otherwise qualifies with respect to more than one person, the child is treated as a qualifying child only of the person with the highest modified adjusted gross income.

"Modified adjusted gross income" means adjusted gross income determined without regard to certain losses and increased by certain amounts not includible in gross income.[17] The losses disregarded are: (1) net capital losses (up to $3,000); (2) net losses from estates and trusts; (3) net losses from nonbusiness rents and royalties; (4) 75 percent of the net losses from businesses, computed separately with respect to sole proprietorships (other than farming), farming sole proprietorships, and other businesses. The amounts added to adjusted gross income to arrive at modified adjusted gross income include: (1) tax-exempt interest; and (2) nontaxable distributions from pensions, annuities, and individual retirement plans (but not nontaxable rollover distributions or trustee-to-trustee transfers).

Definition of earned income

To claim the earned income credit, the taxpayer must have earned income. Earned income consists of wages, salaries, other employee compensation, and net earnings from self employment.[18] Employee compensation includes anything of value received by the taxpayer from the employer in return for services of the employee, including nontaxable earned income. Nontaxable forms of compensation treated as earned income include the following: (1) elective deferrals under a cash or deferred arrangement or section

[15] A child who is legally adopted or placed with the taxpayer for adoption by an authorized adoption agency is treated as the taxpayer's own child. Sec. 32(c)(3)(B)(iv).
[16] Sec. 32(c)(3)(B)(ii).
[17] Sec. 32(c)(5).
[18] Sec. 32(c)(2)(A).

403(b) annuity (sec. 402(g)); (2) employer contributions for nontaxable fringe benefits, including contributions for accident and health insurance (sec. 106), dependent care (sec. 129), adoption assistance (sec. 137), educational assistance (sec. 127), and miscellaneous fringe benefits (sec. 132); (3) salary reduction contributions under a cafeteria plan (sec. 125); (4) meals and lodging provided for the convenience of the employer (sec. 119), and (5) housing allowance or rental value of a parsonage for the clergy (sec. 107). Some of these items are not required to be reported on the Wage and Tax Statement (Form W–2).

Calculation of the credit

The maximum earned income credit is phased in as an individual's earned income increases. The credit phases out for individuals with earned income (or if greater, modified adjusted gross income) over certain levels. In the case of a married individual who files a joint return, the earned income credit both for the phase-in and phase-out is calculated based on the couples' combined income.

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

For taxpayers with modified adjusted gross income (or earned income, if greater) in excess of the phase-out threshold, the credit amount is reduced by the phase-out rate multiplied by the amount of earned income (or modified adjusted gross income, if greater) in excess of the phase-out threshold. In other words, the credit amount is reduced, falling to $0 at the "breakeven" income level, the point where a specified percentage of "excess" income above the phase-out threshold offsets exactly the maximum amount of the credit. The earned income amount and the phase-out threshold are adjusted annually for inflation. Table 18, below, shows the earned income credit parameters for taxable year 2001.[19]

TABLE 18.—EARNED INCOME CREDIT PARAMETERS (2001)

	Two or more qualifying children	One qualifying child	No qualifying children.
Credit rate (percent)	40.00%	34.00%	7.65%
Earned income amount	$10,020	$7,140	$4,760
Maximum credit	$4,008	$2,428	$364
Phase-out begins	$13,090	$13,090	$5,950
Phase-out rate (percent)	21.06%	15.98%	7.65%
Phase-out ends	$32,121	$28,281	$10,710

An individual's alternative minimum tax liability reduces the amount of the refundable earned income credit.[20]

[19] The table is based on Rev. Proc. 2001–13.
[20] Sec. 32(h).

HOUSE BILL

The House bill provides that the earned income credit will no longer be reduced by the amount of the alternative minimum tax. The same provision is included in H.R. 6, as passed by the House.

In addition, H.R. 6 increases the earned income amount used to calculate the earned income credit for married taxpayers who file a joint return to 110 percent of the earned income amount for all other taxpayers eligible for the earned income credit.

H.R. 6 also simplifies the definition of earned income by excluding nontaxable earned income amounts from the definition of earned income for earned income credit purposes. Thus, under H.R. 6, earned income includes wages, salaries, tips, and other employee compensation, if includible in gross income for the taxable year, plus net earnings from self-employment.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2000.

SENATE AMENDMENT

For married taxpayers who file a joint return, the Senate amendment increases the beginning and ending of the earned income credit phase-out by $3,000. These beginning and ending points are to be adjusted annually for inflation after 2002.

The Senate amendment simplifies the definition of earned income by excluding nontaxable employee compensation from the definition of earned income for earned income credit purposes. Thus, under the Senate amendment, earned income includes wages, salaries, tips, and other employee compensation, if includible in gross income for the taxable year, plus net earnings from self employment.

The Senate amendment repeals the present-law provision that reduces the earned income credit by the amount of an individual's alternative minimum tax.

The Senate amendment simplifies the calculation of the earned income credit by replacing modified adjusted gross income with adjusted gross income.

The Senate amendment provides that the relationship test is met if the individual is the taxpayer's son, daughter, stepson, stepdaughter, or a descendant of any such individuals.[21] A brother, sister, stepbrother, stepsister, or a descendant of such individuals, also qualifies if the taxpayer cares for such individual as his or her own child. A foster child satisfies the relationship test as well. A foster child is defined as an individual who is placed with the taxpayer by an authorized placement agency and who the taxpayer cares for as his or her own child. In order to be a qualifying child, in all cases the child must have the same principal place of abode as the taxpayer for over one-half of the taxable year.

The Senate amendment changes the present-law tie-breaking rule. Under the Senate amendment, if an individual would be a qualifying child with respect to more than one taxpayer, and more than one taxpayer claims the earned income credit with respect to that child, then the following tie-breaking rules apply. First, if one

[21] As under present law, an adopted child is treated as a child of the taxpayer by blood.

of the individuals claiming the child is the child's parent (or parents who file a joint return), then the child is considered the qualifying child of the parent (or parents). Second, if both parents claim the child and the parents do not file a joint return together, then the child is considered a qualifying child first of the parent with whom the child resided for the longest period of time during the year, and second of the parent with the highest adjusted gross income. Finally, if none of the taxpayers claiming the child as a qualifying child is the child's parent, the child is considered a qualifying child with respect to the taxpayer with the highest adjusted gross income.

The Senate amendment authorizes the IRS, beginning in 2004, to use math error authority to deny the earned income credit if the Federal Case Registry of Child Support Orders indicates that the taxpayer is the noncustodial parent of the child with respect to whom the credit is claimed.

It is the intent of the Senate that by September 2002, the Department of the Treasury, in consultation with the National Taxpayer Advocate, deliver to the Senate Committee on Finance and the House Committee on Ways and Means a study of the Federal Case Registry database. The study is to cover (1) the accuracy and timeliness of the data in the Federal Case Registry, (2) the efficacy of using math error authority in this instance in reducing costs due to erroneous or fraudulent claims, and (3) the implications of using math error authority in this instance, given the findings on the accuracy and timeliness of the data.

Effective date.—The Senate amendment generally is effective for taxable years beginning after December 31, 2001. The Senate amendment to authorize the IRS to use math error authority if the Federal Case Registry of Child Support Orders indicates the taxpayer is the noncustodial parent is effective beginning in 2004.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, except under the conference agreement, for married taxpayers filing a joint return, the earned income credit phase-out amount is increased as follows: by $1,000 in the case of taxable years beginning in 2002, 2003, and 2004; by $2,000 in the case of taxable years beginning in 2005, 2006, and 2007; and by $3,000 in the case of taxable years beginning after 2007. The $3,000 amount is to be adjusted annually for inflation after 2008.

The conferees realize that the expansion of the earned income credit may create a financial hardship on U.S. possessions with mirror codes and that further study of such effects is necessary.

IV. EDUCATION INCENTIVES

A. Modifications to Education IRAs (Sec. 401 and 414 of the Senate Amendment and Secs. 530 and 127 of the Code)

PRESENT LAW

In general

Section 530 of the Code provides tax-exempt status to education individual retirement accounts ("education IRAs"), meaning

certain trusts or custodial accounts which are created or organized in the United States exclusively for the purpose of paying the qualified higher education expenses of a designated beneficiary. Contributions to education IRAs may be made only in cash.[22] Annual contributions to education IRAs may not exceed $500 per beneficiary (except in cases involving certain tax-free rollovers, as described below) and may not be made after the designated beneficiary reaches age 18.

Phase-out of contribution limit

The $500 annual contribution limit for education IRAs is generally phased-out ratably for contributors with modified adjusted gross income (between $95,000 and $110,000). The phase-out range for married taxpayers filing a joint return is $150,000 to $160,000 of modified adjusted gross income. Individuals with modified adjusted gross income above the phase-out range are not allowed to make contributions to an education IRA established on behalf of any individual.

Treatment of distributions

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 beneficiary to the extent that the total distribution does not exceed the "qualified higher education expenses" incurred by the beneficiary during the year the distribution is made.

If the qualified higher education expenses of the beneficiary for the year are less than the total amount of the distribution (i.e., contributions and earnings combined) from an education IRA, then the qualified higher education expenses are deemed to be paid from a pro-rata share of both the principal and earnings components of the distribution. Thus, in such a case, only a portion of the earnings are excludable (i.e., the portion of the earnings based on the ratio that the qualified higher education expenses bear to the total amount of the distribution) and the remaining portion of the earnings is includible in the beneficiary's gross income.

The earnings portion of a distribution from an education IRA that is includible in income is also subject to an additional 10-percent tax. The 10-percent additional tax does not apply if a distribution is made on account of the death or disability of the designated beneficiary, or on account of a scholarship received by the designated beneficiary.

The additional 10-percent tax also does not apply to the distribution of any contribution to an education IRA made during the taxable year if such distribution is made on or before the date that a return is required to be filed (including extensions of time) by the beneficiary for the taxable year during which the contribution was made (or, if the beneficiary is not required to file such a return, April 15th of the year following the taxable year during which the contribution was made).

[22] Special estate and gift tax rules apply to contributions made to and distributions made from education IRAs.

Present law allows tax-free transfers or rollovers of account balances from one education IRA benefiting one beneficiary to another education IRA benefiting another beneficiary (as well as redesignations of the named beneficiary), provided that the new beneficiary is a member of the family of the old beneficiary and is under age 30.

Any balance remaining in an education IRA is deemed to be distributed within 30 days after the date that the beneficiary reaches age 30 (or, if earlier, within 30 days of the date that the beneficiary dies).

Qualified higher education expenses

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. 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 State tuition program, as defined in section 529, for the benefit of the beneficiary of the education IRA.

Moreover, qualified higher education expenses include, within limits, room and board expenses for any academic period during which the beneficiary is at least a half-time student. Room and board expenses that may be treated as qualified higher education expenses are limited to the minimum room and board allowance applicable to the student in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher Education Act of 1965, as in effect on the date of enactment of the Small Business Job Protection Act of 1996 (August 20, 1996). Thus, room and board expenses cannot exceed the following amounts: (1) for a student living at home with parents or guardians, $1,500 per academic year; (2) for a student living in housing owned or operated by the eligible education institution, the institution's "normal" room and board charge; and (3) for all other students, $2,500 per academic year.

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

Present law also provides that if any qualified higher education expenses are taken into account in determining the amount of the exclusion for a distribution from an education IRA, then no deduction (e.g., for trade or business expenses), exclusion (e.g., for interest on education savings bonds) or credit is allowed with respect to such expenses.

Eligible educational institutions are defined by reference to section 481 of the Higher Education Act of 1965. Such institutions generally are accredited post-secondary educational institutions offering credit toward a bachelor's degree, an associate's degree, a graduate-level or professional degree, or another recognized post-secondary credential. Certain proprietary institutions and post-secondary vocational institutions also are eligible institutions. The institution must be eligible to participate in Department of Education student aid programs.

Time for making contributions

Contributions to an education IRA for a taxable year are taken into account in the taxable year in which they are made.

Coordination with HOPE and Lifetime Learning credits

If an exclusion from gross income is allowed for distributions from an education IRA with respect to an individual, then neither the HOPE nor Lifetime Learning credit may be claimed in the same taxable year with respect to the same individual. However, an individual may elect to waive the exclusion with respect to distributions from an education IRA. If such a waiver is made, then the HOPE or Lifetime Learning credit may be claimed with respect to the individual for the taxable year.

Coordination with qualified tuition programs

An excise tax is imposed on contributions to an education IRA for a year if contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary in the same year. The excise tax is equal to 6 percent of the contributions to the education IRA. The excise tax is imposed each year after the contribution is made, unless the contributions are withdrawn.

HOUSE BILL

No provision.

SENATE AMENDMENT

Annual contribution limit

The Senate amendment increases the annual limit on contributions to education IRAs from $500 to $2,000. Thus, aggregate contributions that may be made by all contributors to one (or more) education IRAs established on behalf of any particular beneficiary is limited to $2,000 for each year.

Qualified education expenses

The Senate amendment expands the definition of qualified education expenses that may be paid tax-free from an education IRA to include "qualified elementary and secondary school expenses," meaning expenses for (1) tuition, fees, academic tutoring, special need 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, transpor-

tation, 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 sec. 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 school. Computer software primarily involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is educational in nature.

Phase-out of contribution limit

The Senate amendment increases the phase-out range for married taxpayers filing a joint return so that it is twice the range for single taxpayers. Thus, the phase-out range for married taxpayers filing a joint return is $190,000 to $220,000 of modified adjusted gross income.

Special needs beneficiaries

The Senate amendment provides that the rule prohibiting contributions to an education IRA after the beneficiary attains 18 does not apply in the case of a special needs beneficiary (as defined by Treasury Department regulations). In addition, a deemed distribution of any balance in an education IRA does not occur when a special needs beneficiary reaches age 30. Finally, the age 30 limitation does not apply in the case of a rollover contribution for the benefit of a special needs beneficiary or a change in beneficiaries to a special needs beneficiary.

Contributions by persons other than individuals

The Senate amendment clarifies that corporations and other entities (including tax-exempt organizations) are permitted to make contributions to education IRAs, regardless of the income of the corporation or entity during the year of the contribution.

Exclusion for employer contributions

The Senate amendment provides an exclusion from gross income for certain employer contributions to an education IRA for the employee, the employee's spouse, or a lineal descendent of the employee or his or her spouse (provided such individual otherwise meets the eligibility requirements for education IRAs). The maximum amount excludable is $500 per year per each beneficiary. Thus, for example, if an employee has two children under age 18, the employer could contribute $500 each year to an education IRA for each child. The exclusion does not apply to self-employed individuals. The employer is required to report the amount of any education IRA contributions on the employee's W–2 for the year.

In order to be excludable from gross income, the contribution must be made pursuant to a plan that meets the requirements of an educational assistance program under section 127.[23] Thus, for

[23] Contributions to education IRAs are not subject to the $5,250 annual limit on the exclusion for employer-provided educational assistance, and are not taken into account for purposes of applying that limit to other education assistance. Rather, such contributions are subject to the $500 per beneficiary limit described above.

example, the plan must be in writing and must satisfy nondiscrimination rules.

Education IRA contributions that are excludable from gross income are treated as earnings for purposes of determining the amount includible in gross income, if any, due to a withdrawal from the education IRA.

The exclusion does not apply for Social Security tax purposes.

Contributions permitted until April 15

Under the Senate amendment, individual contributors to education IRAs are deemed to have made a contribution on the last day of the preceding taxable year if the contribution is made on account of such taxable year and is made not later than the time prescribed by law for filing the individual's Federal income tax return for such taxable year (not including extensions). Thus, individual contributors generally may make contributions for a year until April 15 of the following year.

Qualified room and board expenses

The Senate amendment modifies the definition of room and board expenses considered to be qualified higher education expenses. This modification is described with the provisions relating to qualified tuition programs, below.

Coordination with HOPE and Lifetime Learning credits

The Senate amendment allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the contributions and the earnings portions) from an education IRA on behalf of the same student as long as the distribution is not used for the same educational expenses for which a credit was claimed.

Coordination with qualified tuition programs

The Senate amendment repeals the excise tax on contributions made by any person to an education IRA on behalf of a beneficiary during any taxable year in which any contributions are made by anyone to a qualified State tuition program on behalf of the same beneficiary.

If distributions from education IRAs and qualified tuition programs exceed the beneficiary's qualified higher education expenses for the year (after reduction by amounts used in claiming the HOPE or Lifetime Learning credit), the beneficiary is required to allocate the expenses between the distributions to determine the amount includible in income.

Effective date.—The provisions modifying education IRAs are effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, except that the conference agreement does not include the exclusion for employer contributions. As under the Senate amendment, the conference agreement provides that certain age limitations do not apply in the case of special needs beneficiaries. The conferees intend that Treasury regulations will define a special needs bene-

ficiary to include an individual who because of a physical, mental, or emotional condition (including learning disability) requires additional time to complete his or her education. The conference agreement clarifies the rule relating to computer software by providing that computer software involving sports, games, or hobbies is not considered a qualified elementary and secondary school expense unless the software is predominantly educational in nature.

Effective date.—The conference agreement follows the Senate amendment.

B. Private Prepaid Tuition Programs; Exclusion From Gross Income of Education Distributions From Qualified Tuition Programs (Sec. 402 of the Senate Amendment and Sec. 529 of the Code)

PRESENT LAW

Section 529 of the Code 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 (a "savings account plan"). The term "qualified higher education expenses" generally has the same meaning as does the term for purposes of education IRAs (as described above) and, thus, includes expenses for tuition, fees, books, supplies, and equipment required for the enrollment or attendance at an eligible educational institution,[24] as well as certain room and board expenses for any period during which the student is at least a half-time student.

No amount is included in the gross income of a contributor to, or a beneficiary of, a qualified State tuition program with respect to any distribution from, or earnings under, such program, except that (1) amounts distributed or educational benefits provided to a beneficiary 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 (e.g., when a parent receives a refund) are included in the contributor's gross income to the extent such amounts exceed contributions made on behalf of the beneficiary.[25]

A qualified State tuition program is required to provide that purchases or contributions only be made in cash.[26] Contributors and beneficiaries are not allowed to direct the investment of contributions to the program (or earnings thereon). The program is required to maintain a separate accounting for each designated beneficiary. A specified individual must be designated as the beneficiary

[24] An "eligible education institution" is defined the same for purposes of education IRAs (described above) and qualified State tuition programs.

[25] Distributions from qualified State tuition programs are treated as representing a pro-rata share of the contributions and earnings in the account.

[26] Special estate and gift tax rules apply to contributions made to and distributions made from qualified State tuition programs.

at the commencement of participation in a qualified State tuition program (i.e., when contributions are first made to purchase an interest in such a program), unless interests in such a program are purchased by a State or local government or a tax-exempt charity described in section 501(c)(3) as part of a scholarship program operated by such government or charity under which beneficiaries to be named in the future will receive such interests as scholarships.

A transfer of credits (or other amounts) from one account benefiting one designated beneficiary to another account benefiting a different beneficiary is considered a distribution (as is a change in the designated beneficiary of an interest in a qualified State tuition program), unless the beneficiaries are members of the same family. For this purpose, the term "member of the family" means: (1) the spouse of the beneficiary; (2) a son or daughter of the beneficiary or a descendent of either; (3) a stepson or stepdaughter of the beneficiary; (4) a brother, sister, stepbrother or stepsister of the beneficiary; (5) the father or mother of the beneficiary or an ancestor of either; (6) a stepfather or stepmother of the beneficiary; (7) a son or daughter of a brother or sister of the beneficiary; (8) a brother or sister of the father or mother of the beneficiary; (9) a son-in-law, daughter-in-law, father-in-law, mother-in-law, brother-in-law, or sister-in-law of the beneficiary; or (10) the spouse of any person described in (2)–(9).

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, (3) made on account of a scholarship received by the beneficiary, or (4) a rollover distribution.

To the extent that a distribution from a qualified State tuition program is used to pay for qualified tuition and related expenses (as defined in sec. 25A(f)(1)), the beneficiary (or another taxpayer claiming the beneficiary as a dependent) may claim the HOPE credit or Lifetime Learning credit with respect to such tuition and related expenses (assuming that the other requirements for claiming the HOPE credit or Lifetime Learning credit are satisfied and the modified AGI phase-out for those credits does not apply).

HOUSE BILL

No provision.

SENATE AMENDMENT

Qualified tuition program

The Senate amendment expands the definition of "qualified tuition program" to include certain prepaid tuition programs established and maintained by one or more eligible educational institutions (which may be private institutions) that satisfy the requirements under section 529 (other than the present-law State sponsorship rule). In the case of a qualified tuition program maintained by one or more private eligible educational institutions, persons are able to purchase tuition credits or certificates on behalf of a designated beneficiary (as set forth in sec. 529(b)(1)(A)(i)), but would

not be able to make contributions to a savings account plan (as described in sec. 529(b)(1)(A)(ii)). Except to the extent provided in regulations, a tuition program maintained by a private institution is not treated as qualified unless it has received a ruling or determination from the IRS that the program satisfies applicable requirements.

Exclusion from gross income

Under the Senate amendment, an exclusion from gross income is provided for distributions made in taxable years beginning after December 31, 2001, from qualified State tuition programs to the extent that the distribution is used to pay for qualified higher education expenses. This exclusion from gross income is extended to distributions from qualified tuition programs established and maintained by an entity other than a State (or agency or instrumentality thereof) for distributions made in taxable years after December 31, 2003.

Qualified higher education expenses

The Senate amendment provides that, for purposes of the exclusion for distributions from qualified tuition plans, the maximum room and board allowance is the amount applicable to the student in calculating costs of attendance for Federal financial aid programs under section 472 of the Higher Education Act of 1965, as in effect on the date of enactment, or, in the case of a student living in housing owned or operated by an eligible educational institution, the actual amount charged the student by the educational institution for room and board.[27]

Coordination with HOPE and Lifetime Learning credits

The Senate amendment allows a taxpayer to claim a HOPE credit or Lifetime Learning credit for a taxable year and to exclude from gross income amounts distributed (both the principal and the earnings portions) from a qualified tuition program on behalf of the same student as long as the distribution is not used for the same expenses for which a credit was claimed.

Rollovers for benefit of same beneficiary

The Senate amendment provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary is not considered a distribution. This rollover treatment does not apply to more than one transfer within any 12-month period with respect to the same beneficiary.

Member of family

The Senate amendment provides that, for purposes of tax-free rollovers and changes of designated beneficiaries, a "member of the family" includes first cousins of the original beneficiary.

Effective date.—The provisions are effective for taxable years beginning after December 31, 2001, except that the exclusion from gross income for certain distributions from a qualified tuition pro-

[27] This definition also applies to distributions from education IRAs.

gram established and maintained by an entity other than a State (or agency or instrumentality thereof) is effective for taxable years beginning after December 31, 2003.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. The conference agreement modifies the definition of qualified higher education expenses to include expenses of a special needs beneficiary which are necessary in connection with his or her enrollment or attendance at the eligible education institution.[28] A special needs beneficiary would be defined as under the provisions relating to education IRAs, described above.

The conference agreement repeals the present-law rule that a qualified State tuition program must impose a more than de minimis monetary penalty on any refund of earnings not used for qualified higher education expenses of the beneficiary (except in certain circumstances). Instead, the conference agreement imposes an additional 10-percent tax on the amount of a distribution from a qualified tuition plan that is includible in gross income (like the additional tax that applies to such distributions from education IRAs). The same exceptions that apply to the 10-percent additional tax with respect to education IRAs apply. A special rule applies because the exclusion for earnings on distributions used for qualified higher education expenses does not apply to qualified tuition programs of private institutions until 2004. Under the special rule, the additional 10-percent tax does not apply to any payment in a taxable year beginning before January 1, 2004, which is includible in gross income but used for qualified higher education expenses. Thus, for example, the earnings portion of a distribution from a qualified tuition program of a private institution that is made in 2003 and that is used for qualified higher education expenses is not subject to the additional tax, even though the earnings portion is includible in gross income. Conforming the penalty to the education IRA provisions will make it easier for taxpayers to allocate expenses between the various education tax incentives.[29] For example, under the conference agreement, a taxpayer who receives distributions from an education IRA and a qualified tuition program in the same year is required to allocate qualified expenses in order to determine the amount excludable from income. Other interactions between the various provisions also arise under the conference agreement. For example, a taxpayer may need to know the amount excludable from income due to a distribution from a qualified tuition program in order to determine the amount of expenses eligible for the tuition deduction. The conferees expect that the Secretary will exercise the existing authority under sections 529(d) and 530(h) to require appropriate reporting, e.g., the amount of distributions and the earnings portions of distributions (taxable and nontaxable), to facilitate the provisions of the conference agreement.

The conference agreement provides that, in order for a tuition program of a private eligible education institution to be a qualified

[28] This definition also applies to distributions from education IRAs.

[29] The conferees also believe that this change is appropriate in light of the expansion of qualified tuition programs to include programs maintained by private institutions.

tuition program, assets of the program must be held in a trust created or organized in the United States for the exclusive benefit of designated beneficiaries that complies with the requirements under section 408(a)(2) and (5). Under these rules, the trustee must be a bank or other person who demonstrates that it will administer the trust in accordance with applicable requirements and the assets of the trust may not be commingled with other property except in a common trust fund or common investment fund.

As under the Senate amendment, the conference agreement provides that a transfer of credits (or other amounts) from one qualified tuition program for the benefit of a designated beneficiary to another qualified tuition program for the benefit of the same beneficiary is not considered a distribution. This rollover treatment does not apply to more than one transfer within any 12-month period with respect to the same beneficiary. The conferees intend that this provision will allow, for example, transfers between a prepaid tuition program and a savings program maintained by the same State and between a State plan and a private prepaid tuition program.

C. Exclusion for Employer-Provided Educational Assistance (Sec. 411 of the Senate Amendment and Sec. 127 of the Code)

PRESENT LAW

Educational expenses paid by an employer for its employees are generally deductible by the employer.

Employer-paid educational expenses are excludable from the gross income and wages of an employee if provided under a section 127 educational assistance plan or if the expenses qualify as a working condition fringe benefit under section 132. Section 127 provides an exclusion of $5,250 annually for employer-provided educational assistance. The exclusion does not apply to graduate courses beginning after June 30, 1996. The exclusion for employer-provided educational assistance for undergraduate courses expires with respect to courses beginning after December 31, 2001.

In order 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 educational assistance program must not discriminate in favor of highly compensated employees. In addition, not more than five percent of the amounts paid or incurred by the employer during the year for educational assistance under a qualified educational assistance plan can be provided for the class of individuals consisting of more than five percent owners of the employer (and their spouses and dependents).

Educational expenses that do not qualify for the section 127 exclusion may be excludable from income as a working condition fringe benefit.[30] 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

[30] These rules also apply in the event that section 127 expires.

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 education or training that enables a taxpayer to begin working in a new trade or business.[31]

HOUSE BILL

No provision.

SENATE AMENDMENT

The provision extends the exclusion for employer-provided educational assistance to graduate education and makes the exclusion (as applied to both undergraduate and graduate education) permanent.

Effective date.—The provision is effective with respect to courses beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

D. Modifications to Student Loan Interest Deduction (Sec. 412 of the Senate Amendment and Sec. 221 of the Code)

PRESENT LAW

Certain individuals may claim an above-the-line deduction for interest paid on qualified education loans, subject to a maximum annual deduction limit. The deduction is allowed only with respect to interest paid on a qualified education loan during the first 60 months in which interest payments are required. Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60-month period. 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 certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-secondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or

[31] In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses, along with other miscellaneous expenses, exceed two percent of the taxpayer's AGI. An individual's total deductions may also be reduced by the overall limitation on itemized deductions under section 68. These limitations do not apply in determining whether an item is excludable from income as a working condition fringe benefit.

certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

The maximum allowable annual deduction is $2,500. The deduction is phased-out ratably for single taxpayers with modified adjusted gross income between $40,000 and $55,000 and for married taxpayers filing joint returns with modified adjusted gross income between $60,000 and $75,000. The income ranges will be adjusted for inflation after 2002.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the income phase-out ranges for eligibility for the student loan interest deduction to $50,000 to $65,000 for single taxpayers and to $100,000 to $130,000 for married taxpayers filing joint returns. These income phase-out ranges are adjusted annually for inflation after 2002.

The Senate amendment repeals both the limit on the number of months during which interest paid on a qualified education loan is deductible and the restriction that voluntary payments of interest are not deductible.

Effective date.—The provision is effective for interest paid on qualified education loans after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

E. Eliminate Tax on Awards Under the National Health Service Corps Scholarship Program and the F. Edward Hebert Armed Forces Health Professions Scholarship and Financial Assistance Program (Sec. 413 of the Senate Amendment and Sec. 117 of the Code)

PRESENT LAW

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.

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.

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") provide education awards to participants on the condition that the participants provide certain services. In the case of the NHSC 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. Because the recipients are required to perform services in exchange for the education awards, the awards used to pay higher education expenses are taxable income to the recipient.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that amounts received by an individual under the NHSC Scholarship Program or the Armed Forces Scholarship Program are eligible for tax-free treatment as qualified scholarships under section 117, without regard to any service obligation by the recipient. As with other qualified scholarships under section 117, the tax-free treatment does not apply to amounts received by students for regular living expenses, including room and board.

Effective date.—The provision is effective for education awards received after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

F. Tax Benefits for Certain Types of Bonds for Educational Facilities and Activities (Secs. 421–422 of the Senate Amendment and Secs. 142 and 146–148 of the Code)

PRESENT LAW

Tax-exempt bonds

In general

Interest on debt[32] incurred by States or local governments is excluded from income if the proceeds of the borrowing are used to carry out governmental functions of those entities or the debt is repaid with governmental funds (sec. 103).[33] Like other activities carried out or paid for by States and local governments, the construction, renovation, and operation of public schools is an activity eligible for financing with the proceeds of tax-exempt bonds.

[32] Hereinafter referred to as "State or local government bonds."

[33] Interest on this debt is included in calculating the "adjusted current earnings" preference of the corporate alternative minimum tax.

Interest on bonds that nominally are issued by States 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 called "private activity bonds."[34] The term "private person" includes the Federal Government and all other individuals and entities other than States or local governments.

Private activities eligible for financing with tax-exempt private activity bonds

Present law includes several exceptions permitting States or local governments to act as conduits providing tax-exempt financing for private activities. Both capital expenditures and limited working capital expenditures of charitable organizations described in section 501(c)(3) of the Code—including elementary, secondary, and post-secondary schools—may be financed with tax-exempt private activity bonds ("qualified 501(c)(3) bonds").

States or local governments may issue tax-exempt "exempt-facility bonds" to finance property for certain private businesses. Business facilities eligible for this financing include transportation (airports, ports, local mass commuting, and high speed intercity rail facilities); privately owned and/or privately operated public works facilities (sewage, solid waste disposal, local district heating or cooling, and hazardous waste disposal facilities); privately-owned and/or operated low-income rental housing; and certain private facilities for the local furnishing of electricity or gas. A further provision allows tax-exempt financing for "environmental enhancements of hydro-electric generating facilities." Tax-exempt financing also is authorized for capital expenditures for small manufacturing facilities and land and equipment for first-time farmers ("qualified small-issue bonds"), local redevelopment activities ("qualified redevelopment bonds"), and eligible empowerment zone and enterprise community businesses. Tax-exempt private activity bonds also may be issued to finance limited non-business purposes: certain student loans and mortgage loans for owner-occupied housing ("qualified mortgage bonds" and "qualified veterans' mortgage bonds").

Private activity tax-exempt bonds may not be issued to finance schools for private, for-profit businesses.

In most cases, the aggregate volume of private activity tax-exempt bonds is restricted by annual aggregate volume limits imposed on bonds issued by issuers within each State. These annual volume limits are equal to $62.50 per resident of the State, or $187.5 million if greater. The volume limits are scheduled to increase to the greater of $75 per resident of the State or $225 million in calendar year 2002. After 2002, the volume limits will be indexed annually for inflation.

[34] Interest on private activity bonds (other than qualified 501(c)(3) bonds) is a preference item in calculating the alternative minimum tax.

Arbitrage restrictions on tax-exempt bonds

The Federal income tax does not apply to the income of States and local governments that is derived from the exercise of an essential governmental function. To prevent these tax-exempt entities 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. In general, arbitrage profits may be earned only during specified periods (e.g., defined "temporary periods" before funds are needed for the purpose of the borrowing) or on specified types of investments (e.g., "reasonably required reserve or replacement funds"). Subject to limited exceptions, profits that are earned during these periods or on such investments must be rebated to the Federal Government.

Present law includes three exceptions to the arbitrage rebate requirements applicable to education-related bonds. First, issuers of all types of tax-exempt bonds are not required to rebate arbitrage profits if all of the proceeds of the bonds are spent for the purpose of the borrowing within six months after issuance.[35]

Second, in the case of bonds to finance certain construction activities, including school construction and renovation, the six-month period is extended to 24 months. Arbitrage profits earned on construction proceeds are not required to be rebated if all such proceeds (other than certain retainage amounts) are spent by the end of the 24-month period and prescribed intermediate spending percentages are satisfied.[36] Issuers qualifying for this "construction bond" exception may elect to be subject to a fixed penalty payment regime in lieu of rebate if they fail to satisfy the spending requirements.

Third, governmental bonds issued by "small" governments are not subject to the rebate requirement. Small governments are defined as general purpose governmental units that issue no more than $5 million of tax-exempt governmental bonds in a calendar year. The $5 million limit is increased to $10 million if at least $5 million of the bonds are used to finance public schools.

Qualified zone academy bonds

As an alternative to traditional tax-exempt bonds, States and local governments are given the authority to issue "qualified zone academy bonds." Under present law, a total of $400 million of qualified zone academy bonds may be issued in each of 1998 through 2001. The $400 million aggregate bond authority is allocated each year to the States according to their respective populations of individuals below the poverty line. Each State, in turn, allocates the credit to qualified zone academies within such State. A State may carry over any unused allocation for up to two years (three years for authority arising before 2000).

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[35] In the case of governmental bonds (including bonds to finance public schools), the six-month expenditure exception is treated as satisfied if at least 95 percent of the proceeds is spent within six months and the remaining five percent is spent within 12 months after the bonds are issued.

[36] Retainage amounts are limited to no more than five percent of the bond proceeds, and these amounts must be spent for the purpose of the borrowing no later than 36 months after the bonds are issued.

Certain financial institutions (i.e., banks, insurance companies, and corporations actively engaged in the business of lending money) that hold qualified zone academy bonds are entitled to a nonrefundable tax credit in an amount equal to a credit rate multiplied by the face amount of the bond. An eligible financial institution holding a qualified zone academy bond on the credit allowance date (i.e., each one-year anniversary of the issuance of the bond) is entitled to a credit. The credit amount is includible in gross income (as if it were a taxable interest payment on the bond), and the credit may be claimed against regular income tax and alternative minimum tax liability.

The Treasury Department sets the credit rate daily at a rate estimated to allow issuance of qualified zone academy bonds without discount and without interest cost to the issuer. The maximum term of the bonds also is determined by the Treasury Department, so that the present value of the obligation to repay the bond is 50 percent of the face value of the bond. Present value is determined using as a discount rate the average annual interest rate of tax-exempt obligations with a term of 10 years or more issued during the month.

"Qualified zone academy bonds" are defined as bonds issued by a State or local government, provided that: (1) at least 95 percent of the proceeds is used for the purpose of renovating, providing equipment to, developing course materials for use at, or training teachers and other school personnel in a "qualified zone academy" and (2) private entities have promised to contribute to the qualified zone academy certain equipment, technical assistance or training, employee services, or other property or services with a value equal to at least 10 percent of the bond proceeds.

A school is a "qualified zone academy" if (1) the school is a public school that provides education and training below the college level, (2) the school operates a special academic program in cooperation with businesses to enhance the academic curriculum and increase graduation and employment rates, and (3) either (a) the school is located in a designated empowerment zone or a designated enterprise community, or (b) it is reasonably expected that at least 35 percent of the students at the school will be eligible for free or reduced-cost lunches under the school lunch program established under the National School Lunch Act.

HOUSE BILL

No provision.

SENATE AMENDMENT

Increase amount of governmental bonds that may be issued by governments qualifying for the "small governmental unit" arbitrage rebate exception

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. Thus, these governmental units may issue up to $15 million of governmental bonds in a calendar year pro-

vided that at least $10 million of the bonds are used to finance public school construction expenditures.

Allow issuance of tax-exempt private activity bonds for public school facilities

The private activities for which tax-exempt bonds may be issued are expanded to include elementary and secondary public school facilities which are owned by private, for-profit corporations pursuant to public-private partnership agreements with a State or local educational agency. The term school facility includes school buildings and functionally related and subordinate land (including stadiums or other athletic facilities primarily used for school events)[37] 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.

Effective date.—The provisions are effective for bonds issued after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

G. Modify Rules Governing Tax-Exempt Bonds for Section 501(c)(3) Organizations as Applied to Organizations Engaged in Timber Conservation Activities (Sec. 423 of the Senate Amendment and Sec. 145 of the Code)

PRESENT LAW

Interest on State or local government bonds is tax-exempt when the proceeds of the bonds are used to finance activities carried out by or paid for by those governmental units. Interest on bonds issued by State or local governments acting as conduit borrowers for private businesses is taxable unless a specific exception

[37] The present-law limit on the amount of the proceeds of a private activity bond issue that may be used to finance land acquisition does not apply to these bonds.

is included in the Code. One such exemption allows tax-exempt bonds to be issued to finance activities of non-profit organizations described in Code section 501(c)(3) ("qualified 501(c)(3) bonds").

Qualified 501(c)(3) bonds may be issued only to finance exempt, as opposed to unrelated business, activities of these organizations. However, if the bonds are issued to finance property which is intended to be, or is in fact, sold to a private business while the bonds are outstanding, bond interest may be taxable. An example of such an issue would be qualified 501(c)(3) bonds issued to finance purchase of land and standing timber, when the timber was to be sold.

As is true of other private activities receiving tax-exempt financing, beneficiaries of qualified 501(c)(3) bonds are restricted in the arrangements they may have with private businesses relating to control and use of bond-financed property.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment modifies the rules governing issuance of qualified 501(c)(3) bonds to permit issuance of long-term bonds for the acquisition of timber land by organizations a principal purpose of which is conservation of that land as timber land. Under these rules, the bonds will not have to be repaid (to avoid loss of tax-exemption on interest) when the timber is harvested and sold. In addition, the Senate amendment provision allows these section 501(c)(3) organizations to enter into certain otherwise prohibited timber management arrangements with private businesses without losing tax-exemption on bonds used to finance the property and timber.

Effective date.—The provision is effective for bonds issued after December 31, 2001, and before January 1, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

H. Deduction for Qualified Higher Education Expenses (Sec. 431 of the Senate Amendment and New Sec. 222 of the Code)

PRESENT LAW

Deduction for education expenses

Under present law, an individual taxpayer generally may not deduct the education and training expenses of the taxpayer or the taxpayer's dependents. However, a deduction for education expenses generally is allowed under Internal Revenue Code ("the Code") section 162 if the education or training (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, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162–5). Education expenses are not deductible if they relate to

certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed two percent of the taxpayer's adjusted gross income.

HOPE and Lifetime Learning credits

HOPE credit

Under present law, individual taxpayers are allowed to claim a nonrefundable credit, the "HOPE" credit, against Federal income taxes of up to $1,500 per student per year for qualified tuition and related expenses paid for the first two years of the student's post secondary education in a degree or certificate program. The HOPE credit rate is 100 percent on the first $1,000 of qualified tuition and related expenses, and 50 percent on the next $1,000 of qualified tuition and related expenses.[38] The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The HOPE credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.[39] The HOPE credit that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified 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 ranges are indexed for inflation.

The HOPE credit is available for "qualified tuition and related expenses," which include tuition and fees required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax free educational

[38] Thus, an eligible student who incurs $1,000 of qualified tuition and related expenses is eligible (subject to the AGI phase-out) for a $1,000 HOPE credit. If an eligible student incurs $2,000 of qualified tuition and related expenses, then he or she is eligible for a $1,500 HOPE credit.

[39] The HOPE credit may not be claimed against a taxpayer's alternative minimum tax liability.

benefits received by the student (or the taxpayer claiming the credit) during the taxable year.

Lifetime Learning credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to $5,000 of qualified tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return is $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and related expenses per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family—that is, the HOPE credit is computed on a per student basis, while the Lifetime Learning credit is computed on a family wide basis. The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment permits taxpayers an above-the-line deduction for qualified higher education expenses paid by the taxpayer during a taxable year. Qualified higher education expenses are defined in the same manner as for purposes of the HOPE credit.

In 2002 and 2003, taxpayers with adjusted gross income[40] that does not exceed $65,000 ($130,000 in the case of married couples filing joint returns) are entitled to a maximum deduction of $3,000 per year. Taxpayers with adjusted gross income above these thresholds would not be entitled to a deduction. In 2004 and 2005, taxpayers with adjusted gross income that does not exceed $65,000 ($130,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of $5,000 and taxpayers with adjusted gross income that does not exceed $80,000 ($160,000 in the case of married taxpayers filing joint returns) are entitled to a maximum deduction of $2,000.

Taxpayers are not eligible to claim the deduction and a HOPE or Lifetime Learning Credit in the same year with respect to the same student. A taxpayer may not claim a deduction for amounts

[40] The provision contains ordering rules for use in determining adjusted gross income for purposes of the deduction.

taken into account in determining the amount excludable due to a distribution (i.e., the earnings and contribution portion of a distribution) from an education IRA or the amount of interest excludable with respect to education savings bonds. A taxpayer may not claim a deduction for the amount of a distribution from a qualified tuition plan that is excludable from income; however, a taxpayer may claim a deduction for the amount of a distribution from a qualified tuition plan that is not attributable to earnings. Thus, for example, if a taxpayer receives a distribution of $100 from a qualified tuition plan which is used for tuition, $10 of which represents earnings, the taxpayer would be entitled to claim the deduction with respect to the $90 representing a return of contributions. On the other hand, if the distribution were from an education IRA, the $90 would not be eligible for the deduction.

Effective date.—The provision is effective for payments made in taxable years beginning after December 31, 2001, and before January 1, 2006.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with the modification that the maximum deduction in 2004 and 2005 is $4,000 for taxpayers with adjusted gross income that does not exceed $65,000 ($130,000 in the case of married taxpayers filing joint returns).

I. Credit for Interest on Qualified Higher Education Loans (Sec. 432 of the Senate Amendment and New Sec. 25B of the Code)

PRESENT LAW

An above-the-line deduction for interest paid on qualified education loans is permitted during the first 60 months in which interest payments are required. Required payments of interest generally do not include voluntary payments, such as interest payments made during a period of loan forbearance. Months during which interest payments are not required because the qualified education loan is in deferral or forbearance do not count against the 60–month period. No deduction is allowed to an individual if that individual is claimed as a dependent on another taxpayer's return for the taxable year.

The maximum allowable annual deduction is $2,500. The deduction is phased-out ratably for single taxpayers with modified adjusted gross income between $40,000 and $55,000 and for married taxpayers filing joint returns with modified adjusted gross income between $60,000 and $75,000. The income ranges will be adjusted for inflation after 2002.[41]

A qualified education loan generally is defined as any indebtedness incurred solely to pay for certain costs of attendance (including room and board) of a student (who may be the taxpayer, the taxpayer's spouse, or any dependent of the taxpayer as of the time the indebtedness was incurred) who is enrolled in a degree program on at least a half-time basis at (1) an accredited post-sec-

[41] Another section of the Senate amendment makes certain modifications to present law.

ondary educational institution defined by reference to section 481 of the Higher Education Act of 1965, or (2) an institution conducting an internship or residency program leading to a degree or certificate from an institution of higher education, a hospital, or a health care facility conducting postgraduate training.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment permits taxpayers a nonrefundable personal credit for interest paid on qualified education loans during the first 60 months in which interest payments are required. The maximum annual credit available would be $500.

The credit is 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 after 2009.

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.

Effective date.—The provision is effective for taxable years beginning after December 31, 2008.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

J. Deduction for Qualified Emergency Response Expenses of Eligible Emergency Response Professionals (Sec. 433 of the Senate Amendment and New Sec. 224 of the Code)

PRESENT LAW

Employee business expenses are deductible only as an itemized deduction and only to the extent that the expenses, along with the taxpayer's other allowable miscellaneous itemized deductions, exceed two percent of the taxpayer's adjusted gross income. Itemized deductions may be further reduced by the overall limitation on itemized deductions, which generally applies to taxpayers with adjusted gross income in excess of $132,950 (for 2001).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides an above-the-line deduction for qualified expenses paid or incurred during the taxable year by an eligible emergency response professional.

An eligible emergency response professional is (1) a full-time employee of a police or fire department organized and operated by

a government to provide police protection or firefighting or emergency medical services within its jurisdiction, (2) a licensed emergency medical technician employed by a State or nonprofit agency to provide emergency medical services, or (3) a member of a volunteer fire department organized to provide firefighting or emergency medical services within an area that is not provided with other firefighting services. Qualified expenses means unreimbursed expenses for police and firefighter activities (as determined by the Secretary of Treasury).

No other deduction or credit is allowed with respect to the amount taken into account under this provision. A deduction is allowed for qualified expenses under the provision only to the extent the amount of such expenses exceeds the amount excludable under the provisions relating to education savings bonds, education IRAs, and qualified tuition plans.

Effective date.—The Senate amendment applies to taxable years beginning after December 31, 2001, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

K. Enhanced Deduction for Charitable Contribution of Book Inventory for Educational Purposes (Sec. 434 of the Senate Amendment and Sec. 170 of the Code)

PRESENT LAW

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.

Under present law, a taxpayer's deduction for charitable contributions of book inventory generally is limited to the taxpayer's basis (typically, cost) in the inventory. However, certain corporations may claim a deduction in excess of basis for certain charitable contributions to charitable organizations other than private non-operating foundations. This enhanced deduction is equal to the lesser of (1) basis plus one-half of the item's appreciated value (i.e., basis plus one half of fair market value minus basis) or (2) two times basis. To be eligible for an enhanced deduction, (1) the use of the property by the donee must be related to the donee's exempt purpose and be used by the donee solely for the care of the ill, the needy, or infants; (2) the property must not be transferred by the donee in exchange for money, other property, or services; and (3) the taxpayer must receive a written statement from the donee agreeing to such conditions on use of the contributed property. The

taxpayer also must establish that the fair market value of the donated item exceeds basis.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that contributions of book inventory to certain educational organizations are entitled to the present-law enhanced deduction. Eligible educational organizations are (1) educational organizations that normally maintain a regular faculty and curriculum and normally have a regularly enrolled body of pupils or students in attendance at the place where its educational activities are regularly carried on; (2) charities organized primarily for purposes of supporting elementary and secondary education; and (3) charities organized primarily to make books available to the general public at no cost or to operate a literacy program. Present-law requirements relating to use of the property by the donee and provision of a written statement by the donee apply.

Effective date.—The deduction for contributions of book inventory for educational purposes applies to contributions made after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

L. Deduction for Qualified Professional Development Expenses of Elementary and Secondary School Teachers (Sec. 442 of the Senate Amendment and New Sec. 223 of the Code)

PRESENT LAW

Deduction for education expenses

Under present law, an individual taxpayer generally may not deduct the education and training expenses of the taxpayer or the taxpayer's dependents. However, a deduction for education expenses generally is allowed under Internal Revenue Code ("the Code") section 162 if the education or training (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, or requirements of applicable law or regulations, imposed as a condition of continued employment (Treas. Reg. sec. 1.162–5). Education expenses are not deductible if they relate to certain minimum educational requirements or to education or training that enables a taxpayer to begin working in a new trade or business. In the case of an employee, education expenses (if not reimbursed by the employer) may be claimed as an itemized deduction only if such expenses meet the above described criteria for deductibility under section 162 and only to the extent that the expenses, along with other miscellaneous deductions, exceed two percent of the taxpayer's adjusted gross income.

HOPE and Lifetime Learning credits

HOPE credit

Under present law, individual taxpayers are allowed to claim a nonrefundable credit, the "HOPE" credit, against Federal income taxes of up to $1,500 per student per year for qualified tuition and related expenses paid for the first two years of the student's post secondary education in a degree or certificate program. The HOPE credit rate is 100 percent on the first $1,000 of qualified tuition and related expenses, and 50 percent on the next $1,000 of qualified tuition and related expenses.[42] The qualified tuition and related expenses must be incurred on behalf of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer. The HOPE credit is available with respect to an individual student for two taxable years, provided that the student has not completed the first two years of post-secondary education before the beginning of the second taxable year.[43] The HOPE credit that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified 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 ranges are indexed for inflation.

The HOPE credit is available for "qualified tuition and related expenses," which include tuition and fees required to be paid to an eligible educational institution as a condition of enrollment or attendance of an eligible student at the institution. Charges and fees associated with meals, lodging, insurance, transportation, and similar personal, living, or family expenses are not eligible for the credit. The expenses of education involving sports, games, or hobbies are not qualified tuition and related expenses unless this education is part of the student's degree program.

Qualified tuition and related expenses generally include only out-of-pocket expenses. Qualified tuition and related expenses do not include expenses covered by employer-provided educational assistance and scholarships that are not required to be included in the gross income of either the student or the taxpayer claiming the credit. Thus, total qualified tuition and related expenses are reduced by any scholarship or fellowship grants excludable from gross income under section 117 and any other tax free educational benefits received by the student (or the taxpayer claiming the credit) during the taxable year.

Lifetime Learning credit

Individual taxpayers are allowed to claim a nonrefundable credit, the Lifetime Learning credit, against Federal income taxes equal to 20 percent of qualified tuition and related expenses incurred during the taxable year on behalf of the taxpayer, the taxpayer's spouse, or any dependents. For expenses paid after June 30, 1998, and prior to January 1, 2003, up to $5,000 of qualified

[42] Thus, an eligible student who incurs $1,000 of qualified tuition and related expenses is eligible (subject to the AGI phase-out) for a $1,000 HOPE credit. If an eligible student incurs $2,000 of qualified tuition and related expenses, then he or she is eligible for a $1,500 HOPE credit.

[43] The HOPE credit may not be claimed against a taxpayer's alternative minimum tax liability.

tuition and related expenses per taxpayer return are eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return is $1,000). For expenses paid after December 31, 2002, up to $10,000 of qualified tuition and related expenses per taxpayer return will be eligible for the Lifetime Learning credit (i.e., the maximum credit per taxpayer return will be $2,000).

In contrast to the HOPE credit, a taxpayer may claim the Lifetime Learning credit for an unlimited number of taxable years. Also in contrast to the HOPE credit, the maximum amount of the Lifetime Learning credit that may be claimed on a taxpayer's return will not vary based on the number of students in the taxpayer's family—that is, the HOPE credit is computed on a per student basis, while the Lifetime Learning credit is computed on a family wide basis. The Lifetime Learning credit amount that a taxpayer may otherwise claim is phased-out ratably for taxpayers with modified AGI between $40,000 and $50,000 ($80,000 and $100,000 for joint returns).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides an above-the-line deduction for up to $500 of qualified professional development expenses paid or incurred during the taxable year. The deduction is available to kindergarten through 12th grade teachers, instructors, counselors, principals, or aides who work in an elementary or secondary school[44] for at least 900 hours during the school year.

Qualified professional development expenses are tuition, fees, books, supplies, equipment, and transportation required for the enrollment or attendance in a qualified course of instruction. A qualified course of instruction is a course which: (1) is (a) directly related to the curriculum and academic subjects in which the individual provides instruction, (b) designed to enhance the ability of the individual to understand and use State standards for the academic subjects in which the individual provides instruction, (c) designed to provide instruction in how to teach children with different learning styles, particularly children with disabilities and children with special learning needs (including children who are gifted and talented), or (d) designed to provide instruction in how to best discipline children in the classroom and identify early and appropriate interventions to help children described in (c) learn; (2) is tied to (a) challenging State or local content standards and student performance standards or (b) strategies and programs that demonstrate effectiveness in increasing student academic achievement and student performance, or substantially increasing the knowledge and teaching skills of the individual; (3) is of sufficient intensity and duration to have a positive and lasting impact on the performance of the individual in the classroom[45] (which does not

[44] Elementary and secondary schools are defined by reference to section 14101 of the Elementary and Secondary Education Act of 1965.

[45] One-day or short-term workshops and conferences do not satisfy this requirement. This requirement does not apply to an activity that is one component described in a long-term com-

Continued

include one-day or short-term workshops and conferences); and (3) is part of a program of professional development approved and certified by the appropriate local educational agency[46] as furthering the goals described in (1) and (2).

No other deduction or credit is allowed with respect to the amount taken into account under this provision. A deduction is allowed for qualified professional development expenses under the provision only to the extent the amount of such expenses exceeds the amount excludable under the provisions relating to education savings bonds, education IRAs, and qualified tuition plans.

Effective date.—The provision is effective for taxable years beginning after December 31, 2000, and expires on December 31, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

M. Credit for Classroom Materials (Sec. 443 of the Senate Amendment and New Sec. 30B of the Code)

PRESENT LAW

Unreimbursed employee business expenses are deductible only as an itemized deduction and only to the extent that the individual's total miscellaneous itemized deductions (including employee business expenses) exceed two percent of adjusted gross income.

Taxpayers who itemize deductions may claim a deduction for contributions to qualified charitable organizations. Total deductible contributions may not exceed 50 percent of adjusted gross income. Other limits apply in the case of contributions to certain organizations and certain property.

An individual's otherwise allowable itemized deductions may be further limited by the overall limitation on itemized deductions, which reduces itemized deductions for taxpayers with adjusted gross income in excess of $132,950 (for 2001).

Depending on the particular facts and circumstances, a contribution by a teacher to the school and which he or she is employed may be deductible as an unreimbursed employee business expenses or as a charitable contribution.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a nonrefundable personal credit equal to 50 percent of the qualified elementary and secondary education expenses paid or incurred by an eligible educator during the taxable year. The maximum credit cannot exceed $250 in any year. An eligible educators are kindergarten through 12th

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prehensive professional development plan established by the individual and his or her supervisor based on an assessment of the needs of the individual, the individual's students, and the local educational agency involved.

[46] Local education agency is as defined in section 14101 of the Elementary and Secondary Education Act of 1965, as in effect on the date of enactment.

grade teachers, instructors, counselors, principals, or aides who work in an elementary or secondary school[47] for at least 900 hours during the school year. Qualified elementary and secondary education expenses are expenses for books, supplies (other than nonathletic supplies for courses of instruction in health or physical education), computer equipment (including related software and services) and other equipment, and supplementary materials used by an eligible educator in the classroom.

The credit may not exceed the excess (if any) of (1) the taxpayer's regular tax for the taxable year, reduced by the sum of certain other allowable credits over (2) the taxpayer's tentative minimum tax for the taxable year.

No deduction is allowed for any expense for which a credit is allowed under the provision.

A taxpayer may elect not to have the credit apply.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001, and expires on December 31, 2005.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

V. ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAX PROVISIONS

A. PHASEOUT AND REPEAL OF ESTATE AND GENERATION-SKIPPING TRANSFER TAXES; INCREASE IN GIFT TAX UNIFIED CREDIT EFFECTIVE EXEMPTION (SECS. 101, 201, 301, AND 401–402 OF H.R. 8, SECS. 501–542 OF THE SENATE AMENDMENT, SECS. 121, 684, 1014, 1040, 1221, 2001–2210, 2501, 2502, 2503, 2505, 2511, 2601–2663, 4947, 6018, 6019, AND 7701 OF THE CODE, AND NEW SECS. 1022, 2058, 2210, 2664, AND 6716 OF THE CODE)

PRESENT LAW

Estate and gift tax rules

In general

Under present law, a gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. The gift tax and the estate tax are unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death. The unified estate and gift tax rates begin at 18 percent on the first $10,000 of cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over $3 million. In addition, a 5-percent surtax is imposed on cumulative taxable transfers between $10 million and $17,184,000, which has the effect of phasing out the benefit of the graduated rates. Thus, these estates are subject to a top marginal rate of 60 percent. Estates over $17,184,000 are subject to a flat rate of 55 percent on all amounts exceeding the unified credit effec-

[47] Elementary and secondary schools are defined by reference to section 14101 of the Elementary and Secondary Education Act of 1965.

tive exemption amount, as the benefit of the graduated rates has been phased out.

Gift tax annual exclusion

Donors of lifetime gifts are provided an annual exclusion of $10,000 (indexed for inflation occurring after 1997; the inflation-adjusted amount for 2001 remains at $10,000) of transfers of present interests in property to any one donee during the taxable year. If the non-donor spouse consents to split the gift with the donor spouse, then the annual exclusion is $20,000. Unlimited transfers between spouses are permitted without imposition of a gift tax.

Unified credit

A unified credit is available with respect to taxable transfers by gift and at death. The unified credit amount effectively exempts from tax transfers totaling $675,000 in 2001, $700,000 in 2002 and 2003, $850,000 in 2004, $950,000 in 2005, and $1 million in 2006 and thereafter. The benefit of the unified credit applies at the lowest estate and gift tax rates. For example, in 2001, the unified credit applies between the 18-percent and 37-percent estate and gift tax rates. Thus, in 2001, taxable transfers, after application of the unified credit, are effectively subject to estate and gift tax rates beginning at 37 percent.

Transfers to a surviving spouse

In general.—A 100-percent marital deduction generally is permitted for the value of property transferred between spouses. In addition, transfers of a "qualified terminable interest" also are eligible for the marital deduction. A "qualified terminable interest" is property: (1) which passes from the decedent, (2) in which the surviving spouse has a "qualifying income interest for life," and (3) to which an election under these rules applies. A "qualifying income interest for life" exists if: (1) the surviving spouse is entitled to all the income from the property (payable annually or at more frequent intervals) or the right to use property during the spouse's life, and (2) no person has the power to appoint any part of the property to any person other than the surviving spouse.

Transfers to surviving spouses who are not U.S. citizens.—A marital deduction generally is denied for property passing to a surviving spouse who is not a citizen of the United States. A marital deduction is permitted, however, for property passing to a qualified domestic trust of which the noncitizen surviving spouse is a beneficiary. A qualified domestic trust is a trust that has as its trustee at least one U.S. citizen or U.S. corporation. No corpus may be distributed from a qualified domestic trust unless the U.S. trustee has the right to withhold any estate tax imposed on the distribution.

There is an estate tax imposed on (1) any distribution from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse. The tax is computed as an additional estate tax on the estate of the first spouse to die.

Expenses, indebtedness, and taxes

An estate tax deduction is allowed for funeral expenses and administration expenses of an estate. An estate tax deduction also is allowed for claims against the estate and unpaid mortgages on, or any indebtedness in respect of, property for which the value of the decedent's interest therein, undiminished by the debt, is included in the value of the gross estate.

If the total amount of claims and debts against the estate exceeds the value of the property to which the claims relate, an estate tax deduction for the excess is allowed, provided such excess is paid before the due date of the estate tax return. A deduction for claims against the estate generally is permitted only if the claim is allowable by the law of the jurisdiction under which the estate is being administered.

A deduction also is allowed for the full unpaid amount of any mortgage upon, or of any other indebtedness in respect of, any property included in the gross estate (including interest which has accrued thereon to the date of the decedent's death), provided that the full value of the underlying property is included in the decedent's gross estate.

Basis of property received

In general.—Gain or loss, if any, on the disposition of the property is measured by the taxpayer's amount realized (e.g., gross proceeds received) on the disposition, less the taxpayer's basis in such property. Basis generally represents a taxpayer's investment in property with certain adjustments required after acquisition. For example, basis is increased by the cost of capital improvements made to the property and decreased by depreciation deductions taken with respect to the property.

Property received from a donor of a lifetime gift takes a carryover basis. "Carryover basis" means that the basis in the hands of the donee is the same as it was in the hands of the donor. The basis of property transferred by lifetime gift also is increased, but not above fair market value, by any gift tax paid by the donor. The basis of a lifetime gift, however, generally cannot exceed the property's fair market value on the date of the gift. If the basis of the property is greater than the fair market value of the property on the date of gift, then, for purposes of determining loss, the basis is the property's fair market value on the date of gift.

Property passing from a decedent's estate generally takes a stepped-up basis. "Stepped-up basis" for estate tax purposes means that the basis of property passing from a decedent's estate generally is the fair market value on the date of the decedent's death (or, if the alternate valuation date is elected, the earlier of six months after the decedent's death or the date the property is sold or distributed by the estate). This step up (or step down) in basis eliminates the recognition of income on any appreciation of the property that occurred prior to the decedent's death, and has the effect of eliminating the tax benefit from any unrealized loss.

Special rule for community property.—In community property states, a surviving spouse's one-half share of community property held by the decedent and the surviving spouse (under the community property laws of any State, U.S. possession, or foreign country)

generally is treated as having passed from the decedent, and thus is eligible for stepped-up basis. This rule applies if at least one-half of the whole of the community interest is includible in the decedent's gross estate.

Special rules for interests in certain foreign entities.—Stepped-up basis treatment generally is denied to certain interests in foreign entities. Under present law, stock or securities in a foreign personal holding company take a carryover basis. Stock in a foreign investment company takes a stepped up basis reduced by the decedent's ratable share of the company's accumulated earnings and profits. In addition, stock in a passive foreign investment company (including those for which a mark-to-market election has been made) generally takes a carryover basis, except that a passive foreign investment company for which a decedent shareholder had made a qualified electing fund election is allowed a stepped-up basis. Stock owned by a decedent in a domestic international sales corporation (or former domestic international sales corporation) takes a stepped-up basis reduced by the amount (if any) which would have been included in gross income under section 995(c) as a dividend if the decedent had lived and sold the stock at its fair market value on the estate tax valuation date (i.e., generally the date of the decedent's death unless an alternate valuation date is elected).

Provisions affecting small and family-owned businesses and farms

Special-use valuation.—An executor can elect to value for estate tax purposes certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current-use value, rather than its fair market value. The maximum reduction in value for such real property is $750,000 (adjusted for inflation occurring after 1997; the inflation-adjusted amount for 2001 is $800,000). Real property generally can qualify for special-use valuation if at least 50 percent of the adjusted value of the decedent's gross estate consists of a farm or closely-held business assets in the decedent's estate (including both real and personal property) and at least 25 percent of the adjusted value of the gross estate consists of farm or closely-held business property. In addition, the property must be used in a qualified use (e.g., farming) by the decedent or a member of the decedent's family for five of the eight years before the decedent's death.

If, after a special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years of the decedent's death, an additional estate tax is imposed in order to recapture the entire estate-tax benefit of the special-use valuation.

Family-owned business deduction.—An estate is permitted to deduct the adjusted value of a qualified-family owned business interest of the decedent, up to $675,000.[48] A qualified family-owned

[48] The qualified family-owned business deduction and the unified credit effective exemption amount are coordinated. If the maximum deduction amount of $675,000 is elected, then the unified credit effective exemption amount is $625,000, for a total of $1.3 million. If the qualified family-owned business deduction is less than $675,000, then the unified credit effective exemption amount is equal to $625,000, increased by the difference between $675,000 and the amount

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

To qualify for the exclusion, the decedent (or a member of the decedent's family) must have owned and materially participated in the trade or business for at least five of the eight years preceding the decedent's date of death. In addition, at least one qualified heir (or member of the qualified heir's family) is required to materially participate in the trade or business for at least 10 years following the decedent's death.

The qualified family-owned business rules provide a graduated recapture based on the number of years after the decedent's death in which the disqualifying event occurred. Under the provision, if the disqualifying event occurred within six years of the decedent's death, then 100 percent of the tax is recaptured. The remaining percentage of recapture based on the year after the decedent's death in which a disqualifying event occurs is as follows: the disqualifying event occurs during the seventh year after the decedent's death, 80 percent; during the eighth year after the decedent's death, 60 percent; during the ninth year after the decedent's death, 40 percent; and during the tenth year after the decedent's death, 20 percent. For purposes of the qualified family-owned business deduction, the contribution of a qualified conservation easement is not considered a disposition that would trigger recapture of estate tax.

In general, there is no requirement that the qualified heir (or members of his or her family) continue to hold or participate in the trade or business more than 10 years after the decedent's death. However, the 10-year recapture period can be extended for a period of up to two years if the qualified heir does not begin to use the property for a period of up to two years after the decedent's death.

An estate can claim the benefits of both the qualified family-owned business deduction and special-use valuation. For purposes of determining whether the value of the trade or business exceeds 50 percent of the decedent's gross estate, then the property's special-use value is used if the estate claimed special-use valuation.

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of the qualified family-owned business deduction. However, the unified credit effective exemption amount cannot be increased above such amount in effect for the taxable year.

State death tax credit

A credit is allowed against the Federal estate tax for any estate, inheritance, legacy, or succession taxes actually paid to any State or the District of Columbia with respect to any property included in the decedent's gross estate. The maximum amount of credit allowable for State death taxes is determined under a graduated rate table, the top rate of which is 16 percent, based on the size of the decedent's adjusted taxable estate. Most States impose a "pick-up" or "soak-up" estate tax, which serves to impose a State tax equal to the maximum Federal credit allowed.

Estate and gift taxation of nonresident noncitizens

Nonresident noncitizens are subject to gift tax with respect to certain transfers by gift of U.S.-situated property. Such property includes real estate and tangible property located within the United States. Nonresident noncitizens generally are not subject to U.S. gift tax on the transfer of intangibles, such as stock or securities, regardless of where such property is situated.

Estates of nonresident noncitizens generally are taxed at the same estate tax rates applicable to U.S. citizens, but the taxable estate includes only property situated within the United States that is owned by the decedent at death. This includes the value at death of all property, real or personal, tangible or intangible, situated in the United States. Special rules apply which treat certain property as being situated within and without the United States for these purposes.

Unless modified by a treaty, a nonresident who is not a U.S. citizen generally is allowed a unified credit of $13,000, which effectively exempts $60,000 in assets from estate tax.

Generation-skipping transfer tax

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. The generation-skipping transfer tax is imposed at a flat rate of 55 percent (i.e., the top estate and gift tax rate) on cumulative generation-skipping transfers in excess of $1 million (indexed for inflation occurring after 1997; the inflation-adjusted amount for 2001 is $1,060,000).

Selected income tax provisions

Transfers to certain foreign trusts and estates

A transfer (during life or at death) by a U.S. person to a foreign trust or estate generally is treated as a sale or exchange of the property for an amount equal to the fair market value of the transferred property. The amount of gain that must be recognized by the transferor is equal to the excess of the fair market value of the property transferred over the adjusted basis (for purposes of determining gain) of such property in the hands of the transferor.

Net operating loss and capital loss carryovers

Under present law, a capital loss and net operating loss from business operations sustained by a decedent during his last taxable year are deductible only on the final return filed in his or her behalf. Such losses are not deductible by his or her estate.

Transfers of property in satisfaction of a pecuniary bequest

Under present law, gain or loss is recognized on the transfer of property in satisfaction of a pecuniary bequest (i.e., a bequest of a specific dollar amount) to the extent that the fair market value of the property at the time of the transfer exceeds the basis of the property, which generally is the basis stepped up to fair market value on the date of the decedent's death.

Income tax exclusion for the gain on the sale of a principal residence

A taxpayer generally can 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. The exclusion is allowed each time a taxpayer sells or exchanges a principal residence that meets the eligibility requirements, but generally no more frequently than once every two years.

To be eligible, a taxpayer must have owned the residence and occupied 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 other unforeseen circumstances is able to exclude the fraction of the $250,000 ($500,000 if married filing a joint return) equal to the fraction of two years that these requirements are met.

Excise tax on non-exempt trusts

Under present law, non-exempt split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income, estate, or gift tax charitable deduction was allowed with respect to the trust. A non-exempt split-interest trust subject to these rules would be prohibited from engaging in self-dealing, retaining any excess business holdings, and from making certain investments or taxable expenditures. Failure to comply with these restrictions would subject the trust to certain excise taxes imposed on private foundations, which include excise taxes on self-dealing, excess business holdings, investments which jeopardize charitable purposes, and certain taxable expenditures.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides as follows:

Overview of H.R. 8

Beginning in 2011, the estate, gift, and generation-skipping transfers taxes are repealed. After repeal, the basis of assets received from a decedent generally will equal the basis of the decedent (i.e., carryover basis) at death. However, a decedent's estate is permitted to increase the basis of appreciated assets transferred

by up to a total of $1.3 million. The basis of appreciated property transferred to a surviving spouse can be increased (i.e., stepped up) by an additional $3 million. Thus, the basis of property transferred to a surviving spouse can be increased (i.e., stepped up) by a total of $4.3 million. In no case can the basis of an asset be adjusted above its fair market value. For these purposes, the executor will determine which assets and to what extent each asset receives a basis increase. The $1.3 million and $3 million amounts are adjusted annually for inflation occurring after 2010.

In 2002, the unified credit is replaced with a unified exemption, and the 5-percent surtax (which phases out the benefit of the graduated rates) and the rates in excess of 53 percent are repealed. Beginning in 2003, the estate, gift, and generation-skipping transfer tax rates are further reduced each year until the estate, gift, and generation-skipping transfer taxes are repealed in 2011.

Phaseout and repeal of estate, gift, and generation-skipping transfer taxes

In general

In 2002, the top estate and gift tax rates above 53 percent are repealed, as is the 5-percent surtax, which phases out the benefit of the graduated rates. In 2003, all rates in excess of 50 percent are repealed. In each year 2004 through 2006, each of the rates of tax is reduced by one percentage point. In each year 2007 through 2010, each of the rates of tax is reduced by two percentage points. The generation-skipping transfer tax rate in effect for a given year is the highest estate and gift tax rate in effect for that year. The reduction in estate and gift tax rates is coordinated with the income tax rates such that the highest estate and gift tax rate (and, thus, the generation-skipping transfer tax rate) will not be reduced below the top individual rate, and the lower estate and gift tax rates will not be reduced below the lowest individual tax rate. For each year 2002 through 2010, the State death tax credit rates are reduced in proportion to the reduction in the estate and gift tax rates.

Beginning in 2011, the estate, gift, and generation-skipping transfer taxes are repealed.

Replace unified credit with unified exemption

Beginning in 2002, the unified credit is replaced with a unified exemption amount. The unified exemption amount, which will follow the dollar amounts of the present-law unified credit effective exemption amounts, will be determined as follows: in 2002 and 2003, $700,000; in 2004, $850,000; in 2005, $950,000; and in 2006 and thereafter (until repeal in 2011), $1 million. For decedents who are not residents and not citizens of the United States, the exemption is $60,000.

Basis of property acquired from a decedent

In general

Beginning in 2011, after the estate, gift, and generation-skipping transfer taxes have been repealed, the present-law rules providing for a fair market value basis for property acquired from a

decedent are repealed. Instead, a modified carryover basis regime generally takes effect. Recipients of property transferred at the decedent's death will receive a basis equal the lesser of the adjusted basis of the decedent or the fair market value of the property on the date of the decedent's death.

The modified carryover basis rules apply to property acquired by bequest, devise, or inheritance, or by the decedent's estate from the decedent, property passing from the decedent to the extent such property passed without consideration, and certain other property to which the present law rules apply.[49]

Property acquired from a decedent is treated as if the property had been acquired by gift. Thus, the character of gain on the sale of property received from a decedent's estate is carried over to the heir. For example, real estate that has been depreciated and would be subject to recapture if sold by the decedent will be subject to recapture if sold by the heir.

Property to which the modified carryover basis rules apply

The modified carryover basis rules apply to property acquired from the decedent. Property acquired from the decedent is (1) property acquired by bequest, devise, or inheritance, (2) property acquired by the decedent's estate from the decedent, (3) property transferred by the decedent during his or her lifetime in trust to pay the income for life to or on the order or direction of the decedent, with the right reserved to the decedent at all times before his death to revoke the trust,[50] (4) property transferred by the decedent during his lifetime in trust to pay the income for life to or on the order or direction of the decedent with the right reserved to the decedent at all times before his death to make any change to the enjoyment thereof through the exercise of a power to alter, amend, or terminate the trust,[51] (5) property passing from the decedent by reason of the decedent's death to the extent such property passed without consideration (e.g., property held as joint tenants with right of survivorship or as tenants by the entireties), and (6) the surviving spouse's one-half share of certain community property held by the decedent and the surviving spouse as community property.

Basis increase for certain property

Amount of basis increase.—The bill allows an executor to increase (i.e., step up) the basis in assets owned by the decedent and acquired by the beneficiaries at death. Under this rule, each decedent's estate generally is permitted to increase (i.e., step up) the basis of assets transferred by up to a total of $1.3 million. The $1.3 million is increased by the amount of unused capital losses, net operating losses, and certain "built-in" losses of the decedent. In addition, the basis of property transferred to a surviving spouse can be increased by an additional $3 million. Thus, the basis of property transferred to surviving spouses can be increased by a total of $4.3

[49] Sec. 1014(b)(2) and (3).

[50] This is the same property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(2).

[51] This is the same property the basis of which is stepped up to date of death fair market value under present law sec. 1014(b)(3).

million. Nonresidents who are not U.S. citizens will be allowed to increase the basis of property by up to $60,000. The $60,000, $1.3 million, and $3 million amounts are adjusted annually for inflation occurring after 2010.

Property eligible for basis increase.—In general, the basis of property may be increased above the decedent's adjusted basis in that property only if the property is owned, or is treated as owned, by the decedent at the time of the decedent's death. In the case of property held as joint tenants or tenants by the entireties with the surviving spouse, one-half of the property is treated having been owned by the decedent and is thus eligible for the basis increase. In the case of property held jointly with a person other than the surviving spouse, the portion of the property attributable to the decedent's consideration furnished is treated as having been owned by the decedent and will be eligible for a basis increase. The decedent also is treated as the owner of property (which will be eligible for a basis increase) if the property was transferred by the decedent during his lifetime to a revocable trust that pays all of its income during the decedent's life to the decedent or at the direction of the decedent. The decedent also is treated as having owned the surviving spouse's one-half share of community property (which will be eligible for a basis increase) if at least one-half of the property was owned by, and acquired from, the decedent.[52] The decedent shall not, however, be treated as owning any property solely by reason of holding a power of appointment with respect to such property.

Property not eligible for a basis increase includes: (1) property that was acquired by the decedent by gift (other than from his or her spouse) during the three-year period ending on the date of the decedent's death; (2) property that constitutes a right to receive income in respect of a decedent; (3) stock or securities of a foreign personal holding company; (4) stock of a domestic international sales corporation (or former domestic international sales corporation); (5) stock of a foreign investment company; and (6) stock of a passive foreign investment company (except for which a decedent shareholder had made a qualified electing fund election).

Rules applicable to basis increase.—Basis increase will be allocable on an asset-by-asset basis (e.g., basis increase can be allocated to a share of stock or a block of stock). However, in no case can the basis of an asset be adjusted above its fair market value. If the amount of basis increase is less than the fair market value of assets whose bases are eligible to be increased under these rules, the executor will determine which assets and to what extent each asset receives a basis increase.

Reporting requirements

Lifetime gifts

A donor is required to report to the Internal Revenue Service ("IRS") the basis and character of any non-cash property transferred by gift with a value in excess of $25,000 (except for gifts to

[52] Thus, similar to the present law rule in sec. 1014(b)(6), both the decedent's and the surviving spouse's share of community property could be eligible for a basis increase.

charitable organizations). The donor is required to report to the IRS:

The name and taxpayer identification number of the donee,

An accurate description of the property,

The adjusted basis of the property in the hands of the donor at the time of gift,

The donor's holding period for such property,

Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

And any other information as the Treasury Secretary may prescribe.

Similar information (including the name, address, and phone number of the person making the return) is required to be provided to recipients of such property.

Transfers at death

For transfers at death of non-cash assets in excess of $1.3 million and for appreciated property the value of which exceeds $25,000 received by a decedent within three years of death, the executor of the estate (or the trustee of a revocable trust) would report to the IRS:

The name and taxpayer identification number of the recipient of the property,

An accurate description of the property,

The adjusted basis of the property in the hands of the decedent and its fair market value at the time of death,

The decedent's holding period for the property,

Sufficient information to determine whether any gain on the sale of the property would be treated as ordinary income,

The amount of basis increase allocated to the property, and

Any other information as the Treasury Secretary may prescribe.

Penalties for failure to file required information

Any donor required to report the basis and character of any non-cash property with a value in excess of $25,000 who fails to do so is liable for a penalty of $500 for each failure to report such information to the IRS and $50 for each failure to report such information to a beneficiary.

Any person required to report to the IRS transfers at death of non-cash assets in excess of $1.3 million in value who fails to do so is liable for a penalty of $10,000 for the failure to report such information. Any person required to report to the IRS the receipt by a decedent of appreciated property valued in excess of $25,000 within three years of death who fails to do so is liable for a penalty of $500 for the failure to report such information to the IRS. There also is a penalty of $50 for each failure to report such information to a beneficiary.

No penalty is imposed with respect to any failure that is due to reasonable cause. If any failure to report to the IRS or a beneficiary under the bill is due to intentional disregard of the rules, then the penalty is five percent of the fair market value of the

property for which reporting was required, determined at the date of the decedent's death (for property passing at death) or determined at the time of gift (for a lifetime gift).

Certain tax benefits extending past the date for repeal of the estate tax

Prior to repeal of the estate tax, many estates may have claimed certain estate tax benefits which, upon certain events, may trigger a recapture tax. Because repeal of the estate tax is effective for decedents dying after December 31, 2010, these estate tax recapture provisions will continue to apply to estates of decedents dying before January 1, 2011.

Qualified conservation easements

A donor may have retained a development right in the conveyance of a conservation easement that qualified for the estate tax exclusion. Those with an interest in the land may later execute an agreement to extinguish the right. If an agreement to extinguish development rights is not entered into within the earlier of (1) two years after the date of the decedent's death or (2) the date of the sale of such land subject to the conservation easement, then those with an interest in the land are personally liable for an additional tax. This provision is retained after repeal of the estate tax, which will ensure that those persons with an interest in the land who fail to execute the agreement remain liable for any additional tax which may be due after repeal.

Special-use valuation

Property may have qualified for special-use valuation prior to repeal of the estate tax. If such property ceases to qualify for special-use valuation, for example, because an heir ceases to use the property in its qualified use within 10 years of the decedent's death, then the estate tax benefit is required to be recaptured. The recapture provision is retained after repeal of the estate tax, which will ensure that those estates that claimed this benefit prior to repeal of the estate tax will be subject to recapture if a disqualifying event occurs after repeal.

Qualified family-owned business deduction

Property may have qualified for the family-owned business deduction prior to repeal of the estate tax. If such property ceases to qualify for the family-owned business deduction, for example, because an heir ceases to use the property in its qualified use within 10 years of the decedent's death, then the estate-tax benefit is required to be recaptured. The recapture provision is retained after repeal of the estate tax, which will ensure that those estates that claimed this benefit prior to repeal of the estate tax would be subject to recapture if a disqualifying event occurs after repeal.

Installment payment of estate tax for estates with an interest in a closely-held business

The present-law installment payment rules are retained so that those estates that entered into an installment payment ar-

rangement prior to repeal of the estate tax will continue to make their payments past the date for repeal.

If more than 50 percent of the value of the closely-held business is distributed, sold, exchanged, or otherwise disposed of, the unpaid portion of the tax payable in installments must be paid upon notice and demand from the Treasury Secretary. This rule is retained after repeal of the estate tax, which will ensure that such dispositions that occur after repeal of the estate tax will continue to subject the estate to the unpaid portion of the tax upon notice and demand.

Transfers to foreign trusts, estates, and nonresidents who are not U.S. citizens

The present-law rule providing that transfers by a U.S. person to a foreign trust or estate generally is treated as a sale or exchange is expanded. Under the bill, transfers by a U.S. person to a nonresident who is not a U.S. citizen is treated as a sale or exchange of the property for an amount equal to the fair market value of the transferred property. The amount of gain that must be recognized by the transferor is equal to the excess of the fair market value of the property transferred over the adjusted basis of such property in the hands of the transferor.

Transfers of property in satisfaction of a pecuniary bequest

Under the bill, gain or loss on the transfer of property in satisfaction of a pecuniary bequest is recognized only to the extent that the fair market value of the property at the time of the transfer exceeds the fair market value of the property on the date of the decedent's death (not the property's carryover basis).

Transfer of property subject to a liability

The bill clarifies that gain is not recognized at the time of death when the estate or heir acquires from the decedent property subject to a liability that is greater than the decedent's basis in the property. Similarly, no gain is recognized by the estate on the distribution of such property to a beneficiary of the estate by reason of the liability.

Income tax exclusion for the gain on the sale of a principal residence

The income tax exclusion of up to $250,000 of gain on the sale of a principal residence is extended to estates and heirs. Under the bill, if the decedent's estate or an heir sells the decedent's principal residence, $250,000 of gain can be excluded on the sale of the residence, provided the decedent used the property as a principal residence for two or more years during the five-year period prior to the sale. In addition, if an heir occupies the property as a principal residence, the decedent's period of ownership and occupancy of the property as a principal residence can be added to the heir's subsequent ownership and occupancy in determining whether the property was owned and occupied for two years as a principal residence.

Excise tax on nonexempt trusts

Under the bill, split-interest trusts are subject to certain restrictions that are applicable to private foundations if an income

tax charitable deduction, including an income tax charitable deduction by an estate or trust, was allowed with respect to transfers to the trust.

Anti-abuse rules

The Treasury Secretary is given authority to treat a transfer that purports to be a gift as having never been transferred, if, in connection with such transfer, such treatment is appropriate to prevent income tax avoidance and (1) the transferor (or any person related to or designated by the transferor or such person) has received anything of value in connection with the transfer from the transferee directly or indirectly or (2) there is an understanding or expectation that the transferor (or any person related to or designated by the transferor or such person) will receive anything of value in connection with the transfer from the transferee directly or indirectly.

Study mandated by the bill

The bill requires the Treasury Secretary to conduct a study of opportunities for avoidance of the income tax, if any, and potential increases in income tax revenues by reason of enactment of the bill. The results of such study are required to be submitted to the House Committee on Ways and Means and the Senate Committee on Finance no later than December 31, 2002.

Interaction of the bill with death tax treaties

The Committee expects that, where applicable, references in U.S. tax treaties to the unified credit under section 2010 (as in effect prior to January 1, 2002) will be construed as applying, in a similar manner, to the unified exemption amount (as in effect for decedents dying and gifts made after December 31, 2001).[53]

Effective date.—The unified credit is replaced with a unified exemption, the 5-percent surtax is repealed, and the rates in excess of 53 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2001. The estate and gift tax rates in excess of 50 percent are repealed for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2002.

The additional reductions in estate and gift tax rates and of the State death tax credit occur for decedents dying and gifts and generation-skipping transfers made in 2004 through 2010.

The estate, gift, and generation-skipping transfer taxes are repealed and the carryover basis regime takes effect for estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2010.

The provisions relating to purported gifts and recognition of gain on transfers to nonresidents who are not U.S. citizens are effective for transfers made after December 31, 2010.

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[53] See, e.g., Article 3, Protocol Amending the Convention Between the United States of America and the Federal Republic of Germany for the Avoidance of Double Taxation with Respect to Taxes on Estates, Inheritances, and Gifts (Senate Treaty Doc. 106–13, September 21, 1999.) Under the protocol, a pro rata unified credit is provided to the estate of an individual domiciled in Germany (who is not a U.S. citizen) for purposes of computing U.S. estate tax. Such an individual domiciled in Germany is entitled to a credit against U.S. estate tax based on the extent to which the assets of the estate are situated in the United States.

SENATE AMENDMENT

The Senate amendment is similar to the provision in H.R. 8; however, under the Senate amendment, the gift tax will not be repealed.

The Senate amendment also includes the following modifications:

Phaseout and repeal of estate and generation-skipping transfer taxes; modifications to gift tax

The Senate amendment provides that the unified credit effective exemption amount will be increased and the estate and gift tax rates will be reduced over time. The unified credit effective exemption amount (for estate and gift tax purposes) will be increased to $1 million in 2002. For gift tax purposes, the unified credit effective exemption amount will remain at $1 million in 2002 and thereafter. For estate tax purposes, the unified credit effective exemption amount and generation-skipping transfer tax exemption will increase over time.

TABLE 18.—UNIFIED CREDIT EXEMPTION AMOUNTS AND HIGHEST ESTATE AND GIFT TAX RATES

Calendar year	Estate and GST tax deathtime transfer exemption	Highest estate and gift tax rates
2002	$1 million	50%
2003	$1 million	49%
2004	$2 million	48%
2005	$3 million	47%
2006	$3 million	46%
2007	$3 million	45%
2008	$3 million	45%
2009	$3.5 million	45%
2010	$4 million	45%
2011	N/A (taxes repealed)	40% (gift tax only)

Under the Senate amendment, except as provided in regulations, a transfer to a trust will be treated as a taxable gift beginning in 2011, unless the trust is treated as wholly owned by the donor or the donor's spouse under the grantor trust provisions of the Code.

After repeal of the estate tax, the modified carryover basis rules provided in the House bill also apply under the Senate amendment.

Reduction in State death tax credit; deduction for State death taxes paid

The Senate amendment provides that, from 2002 through 2004, the top State death tax credit rate is decreased from 16 percent as follows: to 8 percent in 2002, to 7.2 percent in 2003, and to 7.04 percent in 2004. In 2005, after the state death tax credit is repealed, there will be a deduction for death taxes (e.g., any estate, inheritance, legacy, or succession taxes) actually paid to any State or the District of Columbia, in respect of property included in the gross estate of the decedent. Such State taxes must have been paid and claimed before the later of: (1) four years after the filing of the estate tax return; or (2) (a) 60 days after a decision

of the U.S. Tax Court determining the estate tax liability becomes final, (b) the expiration of the period of extension to pay estate taxes over time under section 6166, or (c) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has been filed becomes final.

Reporting requirements

In general

For transfers at death, the Senate amendment contains reporting requirements identical to those provided in the House bill. For transfers during life, the Senate amendment provides that a donor is required to provide to recipients of property by gift the information relating to the property (e.g., the fair market value and basis of property) that was reported on the donor's gift tax return with respect to such property.

Penalties for failure to comply with the reporting requirements

Any donor required to provide to recipients of property by gift the information relating to the property that was reported on the donor's gift tax return (e.g., the fair market value and basis of property) with respect to such property who fails to do so is liable for a penalty of $50 for each failure to report such information to a donee.

Any person required to report to the IRS transfers at death of non-cash assets in excess of $1.3 million in value who fails to do so is liable for a penalty of $10,000 for the failure to report such information. Any person required to report to the IRS the receipt by a decedent of appreciated property acquired by the decedent within three years of death for which a gift tax return was required to have been filed by the donor who fails to do so is liable for a penalty of $500 for the failure to report such information to the IRS. There also is a penalty of $50 for each failure to report such information to a beneficiary.

No penalty is imposed with respect to any failure that is due to reasonable cause. If any failure to report to the IRS or a beneficiary under the bill is due to intentional disregard of the rules, then the penalty is five percent of the fair market value of the property for which reporting was required, determined at the date of the decedent's death (for property passing at death) or determined at the time of gift (for a lifetime gift).

Certain tax benefits extending past the date for repeal of the estate tax

As under the House bill, there will continue to be (1) the additional estate tax for those with a retained development right with respect to property for which a conservation easement was claimed, (2) the additional estate tax imposed under the special-use valuation rules, (3) the additional tax imposed under the qualified family-owned business deduction rules, and (4) acceleration of tax under the installment payment of estate tax provisions.

In addition, under the Senate amendment, there will continue to be an estate tax imposed on (1) any distribution prior to January 1, 2022, from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse if such surviving spouse dies before January 1, 2011.

Effective date.—The estate and gift rate reductions, increases in the estate tax unified credit exemption equivalent amounts and generation-skipping transfer tax exemption amount, and reductions in and repeal of the state death tax credit are phased-in over time, beginning with estates of decedents dying and gifts and generation-skipping transfers made after December 31, 2001. The repeal of the qualified family-owned business deduction is effective for estates of decedents dying after December 31, 2003.

The estate and generation-skipping transfer taxes are repealed, and the carryover basis regime takes effect for estates of decedents dying and generation-skipping transfers made after December 31, 2010. The provisions relating to recognition of gain on transfers to nonresident noncitizens are effective for transfers made after December 31, 2010.

The top gift tax rate will be 40 percent, and transfers to trusts generally will be treated as a taxable gift unless the trust is treated as wholly owned by the donor or the donor's spouse, effective for gifts made after December 31, 2010.

An estate tax on distributions made from a qualified domestic trust before the date of the death of the surviving spouse will no longer apply for distributions made after December 31, 2021. An estate tax on the value of property remaining in a qualified domestic trust on the date of death of the surviving spouse will no longer apply after December 31, 2010.

CONFERENCE AGREEMENT

Overview

The conference agreement follows the Senate amendment with modifications. Under the conference agreement, the estate, gift, and generation-skipping transfer taxes are reduced between 2002 and 2009, and the estate and generation-skipping transfer taxes are repealed in 2010.

Phaseout and repeal of estate and generation-skipping transfer taxes

In general

Under the conference agreement, in 2002, the 5-percent surtax (which phases out the benefit of the graduated rates) and the rates in excess of 50 percent are repealed. In addition, in 2002, the unified credit effective exemption amount (for both estate and gift tax purposes) is increased to $1 million. In 2003, the estate and gift tax rates in excess of 49 percent are repealed. In 2004, the estate and gift tax rates in excess of 48 percent are repealed, and the unified credit effective exemption amount for estate tax purposes is increased to $1.5 million. (The unified credit effective exemption amount for gift tax purposes remains at $1 million as increased in 2002.) In addition, in 2004, the family-owned business deduction is

repealed. In 2005, the estate and gift tax rates in excess of 47 percent are repealed. In 2006, the estate and gift tax rates in excess of 46 percent are repealed, and the unified credit effective exemption amount for estate tax purposes is increased to $2 million. In 2007, the estate and gift tax rates in excess of 45 percent are repealed. In 2009, the unified credit effective exemption amount is increased to $3.5 million. In 2010, the estate and generation-skipping transfer taxes are repealed.

From 2002 through 2009, the estate and gift tax rates and unified credit effective exemption amount for estate tax purposes are as follows:

Calendar year	Estate and GST tax deathtime transfer exemption	Highest estate and gift tax rates
2002	$1 million	50%
2003	$1 million	49%
2004	$1.5 million	48%
2005	$1.5 million	47%
2006	$2 million	46%
2007	$2 million	45%
2008	$2 million	45%
2009	$3.5 million	45%
2010	N/A (taxes repealed)	top individual rate under the bill (gift tax only)

The generation-skipping transfer tax exemption for a given year (prior to repeal) is equal to the unified credit effective exemption amount for estate tax purposes. In addition, as under present law, the generation-skipping transfer tax rate for a given year will be the highest estate and gift tax rate in effect for such year.

Repeal of estate and generation-skipping transfer taxes; modifications to gift tax

In 2010, the estate and generation-skipping transfer taxes are repealed. Also beginning in 2010, the top gift tax rate will be the top individual income tax rate as provided under the bill, and, except as provided in regulations, a transfer to trust will be treated as a taxable gift, unless the trust is treated as wholly owned by the donor or the donor's spouse under the grantor trust provisions of the Code.

Reduction in State death tax credit; deduction for State death taxes paid

Under the conference agreement, from 2002 through 2004, the State death tax credit allowable under present law is reduced as follows: in 2002, the State death tax credit is reduced by 25 percent (from present law amounts); in 2003, the State death tax credit is reduced by 50 percent (from present law amounts); and in 2004, the State death tax credit is reduced by 75 percent (from present law amounts). In 2005, the State death tax credit is repealed, after which there will be a deduction for death taxes (e.g., any estate, inheritance, legacy, or succession taxes) actually paid to any State or the District of Columbia, in respect of property included in the gross estate of the decedent. Such State taxes must have been paid and claimed before the later of: (1) four years after the filing of the estate tax return; or (2) (a) 60 days after a decision of the U.S. Tax

Court determining the estate tax liability becomes final, (b) the expiration of the period of extension to pay estate taxes over time under section 6166, or (c) the expiration of the period of limitations in which to file a claim for refund or 60 days after a decision of a court in which such refund suit has become final.

Basis of property acquired from a decedent

The conference agreement includes the rules regarding the determination of basis of property acquired from a decedent after repeal of the estate tax included in H.R. 8 and the Senate amendment; however, these rules will be in effect beginning in 2010 (i.e., when the estate tax is repealed under the conference agreement).

Reporting requirements

The conference agreement follows the Senate amendment.

Certain tax benefits extending past the date for repeal of the estate tax

The conference agreement follows the Senate amendment, with a modification regarding property in a qualified domestic trust. There will continue to be an estate tax imposed on (1) any distribution prior to January 1, 2021, from a qualified domestic trust before the date of the death of the noncitizen surviving spouse and (2) the value of the property remaining in a qualified domestic trust on the date of death of the noncitizen surviving spouse if such surviving spouse dies before January 1, 2010.

Transfers to foreign trusts, foreign estates, and nonresidents who are not U.S. citizens

The conference agreement follows H.R. 8 and the Senate amendment, with a modification. Under the conference agreement, beginning in 2010, only a transfer by a U.S. person's estate (i.e., by a U.S. person at death) to a nonresident who is not a U.S. citizen is treated as a sale or exchange of the property for an amount equal to the fair market value of the transferred property. The amount of gain that must be recognized by the transferor is equal to the excess of the fair market value of the property transferred over the adjusted basis of such property in the hands of the transferor.

Transfers of property in satisfaction of a pecuniary bequest

The conference agreement follows H.R. 8 and the Senate amendment.

Transfer of property subject to a liability

The conference agreement follows H.R. 8 and the Senate amendment.

Income tax exclusion for the gain on the sale of a principal residence

The conference agreement follows H.R. 8 and the Senate amendment, with a modification. Under the conference agreement, the income tax exclusion for the gain on the sale of a principal residence applies to property sold by a trust that was a qualified revocable trust under section 645 of the Code immediately prior to the

decedent's death. The decedent's period of occupancy of the property as a principal residence can be added to an heir's subsequent ownership and occupancy in determining whether the property was owned and occupied for two years as a principal residence, regardless of whether the residence was owned by such trust during the decedent's occupancy.

Excise tax on non-exempt trusts

The conference agreement follows H.R. 8 and the Senate amendment.

Effective date.—The estate and gift rate reductions, increases in the estate tax unified credit exemption equivalent amounts and generation-skipping transfer tax exemption amount, and reductions in and repeal of the state death tax credit are phased-in over time, beginning with estates of decedents dying and gifts and generation-skipping transfers after December 31, 2001. The repeal of the qualified family-owned business deduction is effective for estates of decedents dying after December 31, 2003.

The estate and generation-skipping transfer taxes are repealed, and the carryover basis regime takes effect for estates of decedents dying and generation-skipping transfers after December 31, 2009. The provisions relating to recognition of gain on transfers by the estate of a U.S. person (i.e., at death) to nonresidents who are not U.S. citizens is effective for transfers made after December 31, 2009.

The top gift tax rate will be the top individual income tax rate as provided in the bill, and transfers to trusts generally will be treated as a taxable gift unless the trust is treated as wholly owned by the donor or the donor's spouse, effective for gifts made after December 31, 2009.

An estate tax on distributions made from a qualified domestic trust before the date of the death of the surviving spouse will no longer apply for distributions made after December 31, 2020. An estate tax on the value of property remaining in a qualified domestic trust on the date of death of the surviving spouse will no longer apply after December 31, 2009.

B. Expand Estate Tax Rule for Conservation Easements (Sec. 501 of H.R. 8, Sec. 551 of the Senate Amendment, and Sec. 2031 of the Code)

PRESENT LAW

In general

An executor can elect to exclude from the taxable estate 40 percent of the value of any land subject to a qualified conservation easement, up to a maximum exclusion of $100,000 in 1998, $200,000 in 1999, $300,000 in 2000, $400,000 in 2001, and $500,000 in 2002 and thereafter (sec. 2031(c)). The exclusion percentage is reduced by 2 percentage points for each percentage point (or fraction thereof) by which the value of the qualified conservation easement is less than 30 percent of the value of the land (determined without regard to the value of such easement and reduced by the value of any retained development right).

A qualified conservation easement is one that meets the following requirements: (1) the land is located within 25 miles of a metropolitan area (as defined by the Office of Management and Budget) or a national park or wilderness area, or within 10 miles of an Urban National Forest (as designated by the Forest Service of the U.S. Department of Agriculture); (2) the land has been owned by the decedent or a member of the decedent's family at all times during the three-year period ending on the date of the decedent's death; and (3) a qualified conservation contribution (within the meaning of sec. 170(h)) of a qualified real property interest (as generally defined in sec. 170(h)(2)(C)) was granted by the decedent or a member of his or her family. For purposes of the provision, preservation of a historically important land area or a certified historic structure does not qualify as a conservation purpose.

In order to qualify for the exclusion, a qualifying easement must have been granted by the decedent, a member of the decedent's family, the executor of the decedent's estate, or the trustee of a trust holding the land, no later than the date of the election. To the extent that the value of such land is excluded from the taxable estate, the basis of such land acquired at death is a carryover basis (i.e., the basis is not stepped-up to its fair market value at death). Property financed with acquisition indebtedness is eligible for this provision only to the extent of the net equity in the property.

Retained development rights

The exclusion for land subject to a conservation easement does not apply to any development right retained by the donor in the conveyance of the conservation easement. An example of such a development right would be the right to extract minerals from the land. If such development rights exist, then the value of the conservation easement must be reduced by the value of any retained development right.

If the donor or holders of the development rights agree in writing to extinguish the development rights in the land, then the value of the easement need not be reduced by the development rights. In such case, those persons with an interest in the land must execute the agreement no later than the earlier of (1) two years after the date of the decedent's death or (2) the date of the sale of such land subject to the conservation easement. If such agreement is not entered into within this time, then those with an interest in the land are personally liable for an additional tax, which is the amount of tax which would have been due on the retained development rights subject to the termination agreement.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House expands the availability of qualified conservation easements by modifying the distance requirements. Under the bill, the distance within which the land must be situated from a metropolitan area, national park, or wilderness area is increased from 25 to 50 miles, and the distance from which the land must be situated from an Urban National Forest is increased from 10 to 25 miles. The bill also clarifies

that the date for determining easement compliance is the date on which the donation was made.

Effective date.—The provisions are effective for estates of decedents dying after December 31, 2000.

SENATE AMENDMENT

The Senate amendment expands availability of qualified conservation easements by eliminating the requirement that the land be located within a certain distance from a metropolitan area, national park, wilderness area, or Urban National Forest. Thus, under the Senate amendment, a qualified conservation easement may be claimed with respect to any land that is located in the United States or its possessions. The Senate amendment also clarifies that the date for determining easement compliance is the date on which the donation was made.

Effective date.—The provisions are effective for estates of decedents dying after December 31, 2000.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

C. Modify Generation-Skipping Transfer Tax Rules

1. Deemed allocation of the generation-skipping transfer tax exemption to lifetime transfers to trusts that are not direct skips (sec. 601 of H.R. 8, sec. 561 of the Senate amendment, and sec. 2632 of the Code)

PRESENT LAW

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999; the inflation-adjusted amount for 2001 is $1,060,000) is provided for each person making generation-skipping transfers. The exemption can be allocated by a transferor (or his or her executor) to transferred property.

A direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person. A skip person may be a natural person or certain trusts. All persons assigned to the second or more remote generation below the transferor are skip persons (e.g., grandchildren and great-grandchildren). Trusts are skip persons if (1) all interests in the trust are held by skip persons, or (2) no person holds an interest in the trust and at no time after the transfer may a distribution (including distributions and terminations) be made to a non-skip person.

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribu-

tion is a distribution from a trust to a skip person (other than a taxable termination or direct skip).

The tax rate on generation-skipping transfers is a flat rate of tax equal to the maximum estate and gift tax rate in effect at the time of the transfer (55 percent under present law) multiplied by the "inclusion ratio." The inclusion ratio with respect to any property transferred in a generation-skipping transfer indicates the amount of "generation-skipping transfer tax exemption" allocated to a trust. The allocation of generation-skipping transfer tax exemption reduces the 55-percent tax rate on a generation-skipping transfer.

If an individual makes a direct skip during his or her lifetime, any unused generation-skipping transfer tax exemption is automatically allocated to a direct skip to the extent necessary to make the inclusion ratio for such property equal to zero. An individual can elect out of the automatic allocation for lifetime direct skips.

For lifetime transfers made to a trust that are not direct skips, the transferor must allocate generation-skipping transfer tax exemption—the allocation is not automatic. If generation-skipping transfer tax exemption is allocated on a timely-filed gift tax return, then the portion of the trust which is exempt from generation-skipping transfer tax is based on the value of the property at the time of the transfer. If, however, the allocation is not made on a timely-filed gift tax return, then the portion of the trust which is exempt from generation-skipping transfer tax is based on the value of the property at the time the allocation of generation-skipping transfer tax exemption was made.

Treas. Reg. sec. 26.2632–1(d) further provides that any unused generation-skipping transfer tax exemption, which has not been allocated to transfers made during an individual's life, is automatically allocated on the due date for filing the decedent's estate tax return. Unused generation-skipping transfer tax exemption is allocated pro rata on the basis of the value of the property as finally determined for estate tax purposes, first to direct skips treated as occurring at the transferor's death. The balance, if any, of unused generation-skipping transfer tax exemption is allocated pro rata, on the basis of the estate tax value of the nonexempt portion of the trust property (or in the case of trusts that are not included in the gross estate, on the basis of the date of death value of the trust) to trusts with respect to which a taxable termination may occur or from which a taxable distribution may be made.

HOUSE BILL

No provision. However, H.R. 8, as passed by the house provides that generation-skipping transfer tax exemption will be automatically allocated to transfers made during life that are "indirect skips." An indirect skip is any transfer of property (that is not a direct skip) subject to the gift tax that is made to a generation-skipping transfer trust.

A generation-skipping transfer trust is defined as a trust that could have a generation-skipping transfer with respect to the transferor (e.g., a taxable termination or taxable distribution), unless:

The trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn

by one or more individuals who are non-skip persons (a) before the date that the individual attains age 46, (b) on or before one or more dates specified in the trust instrument that will occur before the date that such individual attains age 46, or (c) upon the occurrence of an event that, in accordance with regulations prescribed by the Treasury Secretary, may reasonably be expected to occur before the date that such individual attains age 46;

The trust instrument provides that more than 25 percent of the trust corpus must be distributed to or may be withdrawn by one or more individuals who are non-skip persons and who are living on the date of death of another person identified in the instrument (by name or by class) who is more than 10 years older than such individuals;

The trust instrument provides that, if one or more individuals who are non-skip persons die on or before a date or event described in clause (1) or (2), more than 25 percent of the trust corpus either must be distributed to the estate or estates of one or more of such individuals or is subject to a general power of appointment exercisable by one or more of such individuals;

The trust is a trust any portion of which would be included in the gross estate of a non-skip person (other than the transferor) if such person died immediately after the transfer;

The trust is a charitable lead annuity trust or a charitable remainder annuity trust or a charitable unitrust; or

The trust is a trust with respect to which a deduction was allowed under section 2522 for the amount of an interest in the form of the right to receive annual payments of a fixed percentage of the net fair market value of the trust property (determined yearly) and which is required to pay principal to a non-skip person if such person is alive when the yearly payments for which the deduction was allowed terminate.

If any individual makes an indirect skip during the individual's lifetime, then any unused portion of such individual's generation-skipping transfer tax exemption is allocated to the property transferred to the extent necessary to produce the lowest possible inclusion ratio for such property.

An individual can elect not to have the automatic allocation rules apply to an indirect skip, and such elections will be deemed timely if filed on a timely-filed gift tax return for the calendar year in which the transfer was made or deemed to have been made or on such later date or dates as may be prescribed by the Treasury Secretary. An individual can elect not to have the automatic allocation rules apply to any or all transfers made by such individual to a particular trust and can elect to treat any trust as a generation-skipping transfer trust with respect to any or all transfers made by the individual to such trust, and such election can be made on a timely-filed gift tax return for the calendar year for which the election is to become effective.

Effective date.—The provision applies to transfers subject to estate or gift tax made after December 31, 2000, and to estate tax inclusion periods ending after December 31, 2000.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

2. Retroactive allocation of the generation-skipping transfer tax exemption (sec. 601 of H.R. 8, sec. 561 of the Senate amendment, and sec. 2632 of the Code)

PRESENT LAW

A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or direct skip). If a transferor allocates generation-skipping transfer tax exemption to a trust prior to the taxable termination or taxable distribution, generation-skipping transfer tax may be avoided.

A transferor likely will not allocate generation-skipping transfer tax exemption to a trust that the transferor expects will benefit only non-skip persons. However, if a taxable termination occurs because, for example, the transferor's child unexpectedly dies such that the trust terminates in favor of the transferor's grandchild, and generation-skipping transfer tax exemption had not been allocated to the trust, then generation-skipping transfer tax would be due even if the transferor had unused generation-skipping transfer tax exemption.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provided that generation-skipping transfer tax exemption can be allocated retroactively when there is an unnatural order of death. If a lineal descendant of the transferor predeceases the transferor, then the transferor can allocate any unused generation-skipping transfer exemption to any previous transfer or transfers to the trust on a chronological basis. The provision allows a transferor to retroactively allocate generation-skipping transfer exemption to a trust where a beneficiary (a) is a non-skip person, (b) is a lineal descendant of the transferor's grandparent or a grandparent of the transferor's spouse, (c) is a generation younger than the generation of the transferor, and (d) dies before the transferor. Exemption is allocated under this rule retroactively, and the applicable fraction and inclusion ratio would be determined based on the value of the property on the date that the property was transferred to trust.

Effective date.—The provision applies to deaths of non-skip persons occurring after December 31, 2000.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

3. Severing of trusts holding property having an inclusion ratio of greater than zero (sec. 602 of H.R. 8, sec. 562 of the Senate amendment, and sec. 2642 of the Code)

PRESENT LAW

A generation-skipping transfer tax generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the generation-skipping transfer tax include direct skips, taxable terminations, and taxable distributions. An exemption of $1 million (indexed beginning in 1999; the inflation-adjusted amount for 2001 is $1,060,000) is provided for each person making generation-skipping transfers. The exemption can be allocated by a transferor (or his or her executor) to transferred property.

If the value of transferred property exceeds the amount of the generation-skipping transfer tax exemption allocated to that property, then the generation-skipping transfer tax generally is determined by multiplying a flat tax rate equal to the highest estate tax rate (which is currently 55 percent) by the "inclusion ratio" and the value of the taxable property at the time of the taxable event. The "inclusion ratio" is the number one minus the "applicable fraction." The applicable fraction is a fraction calculated by dividing the amount of the generation-skipping transfer tax exemption allocated to the property by the value of the property.

Under Treas. Reg. 26.2654–1(b), a trust may be severed into two or more trusts (e.g., one with an inclusion ratio of zero and one with an inclusion ratio of one) only if (1) the trust is severed according to a direction in the governing instrument or (2) the trust is severed pursuant to the trustee's discretionary powers, but only if certain other conditions are satisfied (e.g., the severance occurs or a reformation proceeding begins before the estate tax return is due). Under current Treasury regulations, however, a trustee cannot establish inclusion ratios of zero and one by severing a trust that is subject to the generation-skipping transfer tax after the trust has been created.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that a trust can be severed in a "qualified severance." A qualified severance is defined as the division of a single trust and the creation of two or more trusts if (1) the single trust was divided on a fractional basis, and (2) the terms of the new trusts, in the aggregate, provide for the same succession of interests of beneficiaries as are provided in the original trust. If a trust has an in-

clusion ratio of greater than zero and less than one, a severance is a qualified severance only if the single trust is divided into two trusts, one of which receives a fractional share of the total value of all trust assets equal to the applicable fraction of the single trust immediately before the severance. In such case, the trust receiving such fractional share shall have an inclusion ratio of zero and the other trust shall have an inclusion ratio of one. Under the provision, a trustee may elect to sever a trust in a qualified severance at any time.

Effective date.—The provision is effective for severances of trusts occurring after December 31, 2000.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows the provision in H.R. 8 and the Senate amendment.

4. Modification of certain valuation rules (sec. 603 of H.R. 8, sec. 563 of the Senate amendment, and sec. 2642 of the Code)

PRESENT LAW

Under present law, the inclusion ratio is determined using gift tax values for allocations of generation-skipping transfer tax exemption made on timely filed gift tax returns. The inclusion ratio generally is determined using estate tax values for allocations of generation-skipping transfer tax exemption made to transfers at death. Treas. Reg. 26.2642–5(b) provides that, with respect to taxable terminations and taxable distributions, the inclusion ratio becomes final on the later of the period of assessment with respect to the first transfer using the inclusion ratio or the period for assessing the estate tax with respect to the transferor's estate.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that in connection with timely and automatic allocations of generation-skipping transfer tax exemption, the value of the property for purposes of determining the inclusion ratio shall be its finally determined gift tax value or estate tax value depending on the circumstances of the transfer. In the case of a generation-skipping transfer tax exemption allocation deemed to be made at the conclusion of an estate tax inclusion period, the value for purposes of determining the inclusion ratio shall be its value at that time.

Effective date.—The provision is effective for transfers subject to estate or gift tax made after December 31, 2000.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

5. Relief from late elections (sec. 604 of H.R. 8, sec. 564 of the Senate amendment, and sec. 2642 of the Code)

PRESENT LAW

Under present law, an election to allocate generation-skipping transfer tax exemption to a specific transfer may be made at any time up to the time for filing the transferor's estate tax return. If an allocation is made on a gift tax return filed timely with respect to the transfer to trust, then the value on the date of transfer to the trust is used for determining generation-skipping transfer tax exemption allocation. However, if the allocation relating to a specific transfer is not made on a timely-filed gift tax return, then the value on the date of allocation must be used. There is no statutory provision allowing relief for an inadvertent failure to make an election on a timely-filed gift tax return to allocate generation-skipping transfer tax exemption.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that the Treasury Secretary is authorized and directed to grant extensions of time to make the election to allocate generation-skipping transfer tax exemption and to grant exceptions to the time requirement, without regard to whether any period of limitations has expired. If such relief is granted, then the gift tax or estate tax value of the transfer to trust would be used for determining generation-skipping transfer tax exemption allocation.

In determining whether to grant relief for late elections, the Treasury Secretary is directed to consider all relevant circumstances, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems relevant. For purposes of determining whether to grant relief, the time for making the allocation (or election) is treated as if not expressly prescribed by statute.

Effective date.—The provision applies to requests pending on, or filed after, December 31, 2000. No inference is intended with respect to the availability of relief from late elections prior to the effective date of the provision.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows the provision in H.R. 8 and the Senate amendment.

6. Substantial compliance (sec. 604 of the House bill, sec. 564 of the Senate amendment, and sec. 2642 of the Code)

PRESENT LAW

Under present law, there is no statutory rule which provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or trust.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, provides that substantial compliance with the statutory and regulatory requirements for allocating generation-skipping transfer tax exemption will suffice to establish that generation-skipping transfer tax exemption was allocated to a particular transfer or a particular trust. If a taxpayer demonstrates substantial compliance, then so much of the transferor's unused generation-skipping transfer tax exemption will be allocated to the extent it produces the lowest possible inclusion ratio. In determining whether there has been substantial compliance, all relevant circumstances will be considered, including evidence of intent contained in the trust instrument or instrument of transfer and such other factors as the Treasury Secretary deems appropriate.

Effective date.—The provision applies to transfers subject to estate or gift tax made after December 31, 2000. No inference is intended with respect to the availability of a rule of substantial compliance prior to the effective date of the provision.

SENATE AMENDMENT

The Senate amendment is the same as the provision in H.R. 8.

CONFERENCE AGREEMENT

The conference agreement follows H.R. 8 and the Senate amendment.

D. EXPAND AND MODIFY AVAILABILITY OF INSTALLMENT PAYMENT OF ESTATE TAX FOR CLOSELY-HELD BUSINESSES (SEC. 701 OF H.R. 8, SECS. 571 AND 572 OF THE SENATE AMENDMENT, AND SEC. 6166 OF THE CODE)

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 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 in-

terest. This provision effectively extends the time for paying estate tax by 14 years from the original due date of the estate tax.[54] 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; the inflation-adjusted amount for 2001 is $1,060,000) 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 five-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.

HOUSE BILL

No provision. However, H.R. 8, as passed by the House, expands the definition of a closely-held business for purposes of installment payment of estate tax. The bill increases from 15 to 45 the number of partners in a partnership and shareholders in a corporation that is considered a closely-held business in which a decedent held an interest, and thus will qualify the estate for installment payment of estate tax.

Effective date.—The provision is effective for decedents dying after December 31, 2001.

SENATE AMENDMENT

The Senate amendment expands 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 the estate tax. The bill also provides that an estate with an interest in a qualifying lending and financing business that claims installment payment of estate tax must make installment payments of estate tax (which will include both

[54] 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.

principal and interest) relating to the interest in a qualifying lending and financing business over five years.

The Senate amendment also clarifies that the installment payment provisions require that only the stock of holding companies, not that of operating subsidiaries, must be non-readily tradable in order to qualify for installment payment of the estate tax. The bill also provides that an estate with a qualifying property interest held through holding companies that claims installment payment of estate tax must make all installment payments of estate tax (which will include both principal and interest) relating to a qualifying property interest held through holding companies over five years.

Effective date.—The provision is effective for decedents dying after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement includes the provision in H.R. 8 and the provisions in the Senate amendment.

No inference is intended as to whether one or more of the specified activities of a qualified lending and financing business would be a trade or business eligible for installment payment of estate tax under present law.

VI. PENSION AND INDIVIDUAL RETIREMENT ARRANGEMENT PROVISIONS [55]

A. INDIVIDUAL RETIREMENT ARRANGEMENTS ("IRAS") (SEC. 101 OF THE HOUSE BILL, SECS. 601–603 OF THE SENATE AMENDMENT AND SECS. 219, 408, AND 408A OF THE CODE)

PRESENT LAW

In general

There are two general types of individual retirement arrangements ("IRAs") under present law: traditional IRAs, to which both deductible and nondeductible contributions may be made, and Roth IRAs. The Federal income tax rules regarding each type of IRA (and IRA contribution) differ.

Traditional IRAs

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 neither the individual nor the individual's spouse is an active participant 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

[55] The provisions of the bill as passed by the House did not contain provisions relating to pensions and individual retirement arrangements. Provisions described under the House bill refer to the provisions of H.R. 10, the "Comprehensive Retirement Security and Pension Reform Act of 2001," as passed by the House.

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 taxpayers who are active participants in employer-sponsored plans are as follows.

Single Taxpayers

Taxable years beginning in:	*Phase-out range*
2001	$33,000–43,000
2002	34,000–44,000
2003	40,000–50,000
2004	45,000–55,000
2005 and thereafter	50,000–60,000

Joint Returns

Taxable years beginning in:	*Phase-out range*
2001	$53,000–63,000
2002	54,000–64,000
2003	60,000–70,000
2004	65,000–75,000
2005	70,000–80,000
2006	75,000–85,000
2007 and thereafter	80,000–100,000

The AGI phase-out range for married taxpayers filing a separate return is $0 to $10,000.

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.

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 a traditional IRA.

Amounts held in a traditional 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 59½ 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.

Roth IRAs

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 joint filers with AGI between $150,000 and $160,000.

Taxpayers with modified AGI of $100,000 or less generally may convert a traditional IRA into a 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 four years. Married taxpayers who file separate returns cannot convert a traditional IRA into a Roth IRA.

Amounts held in a Roth IRA that are withdrawn as a qualified distribution are not includible in income, or subject to the additional 10-percent tax on early withdrawals. A qualified distribution is a distribution that (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) which is made after attainment of age 59½, on account of death or disability, or is made for first-time homebuyer expenses of up to $10,000.

Distributions from a Roth IRA that are not qualified distributions are includible in income to the extent attributable to earnings, and subject to the 10-percent early withdrawal tax (unless an exception applies).[56] The same exceptions to the early withdrawal tax that apply to IRAs apply to Roth IRAs.

Taxation of 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. The amount of the deduction otherwise 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.

For donations of cash by individuals, total deductible contributions to public charities may not exceed 50 percent of a taxpayer's adjusted gross income ("AGI") for a taxable year. To the extent a taxpayer has not exceeded the 50-percent limitation, contributions of cash to private foundations and certain other nonprofit organizations and contributions of capital gain property to public charities generally may be deducted up to 30 percent of the taxpayer's AGI. If a taxpayer makes a contribution in one year that exceeds the applicable 50-percent or 30-percent limitation, the excess amount of the contribution may be carried over and deducted during the next five taxable years.

In addition to the percentage limitations imposed specifically on charitable contributions, present law imposes a reduction on most itemized deductions, including charitable contribution deductions, for taxpayers with adjusted gross income in excess of a threshold amount, which is adjusted annually for inflation. The threshold amount for 2001 is $132,950 ($66,475 for married individuals filing separate returns). For those deductions that are subject to the limit, the total amount of itemized deductions is reduced by three percent of AGI over the threshold amount, but not by more than 80 percent of itemized deductions subject to the limit.

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

The effect of this reduction may be to limit a taxpayer's ability to deduct some of his or her charitable contributions.

HOUSE BILL

Increase in annual contribution limits

The House bill increases the maximum annual dollar contribution limit for IRA contributions from $2,000 to $3,000 in 2002, $4,000 in 2003, and $5,000 in 2004. The limit is indexed in $500 increments in 2005 and thereafter.

Additional catch-up contributions

The House bill accelerates the increase of the IRA maximum contribution limit for individuals who have attained age 50 before the end of the taxable year. The maximum dollar contribution limit (before application of the AGI phase-out limits) for such an individual is increased to $5,000 in 2002 and 2003. In 2004 and thereafter, the general limit applies to all individuals.

Deemed IRAs under qualified plans

No provision.

Tax-free IRA withdrawals for charitable purposes

No provision.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

Increase in annual contribution limits

The Senate amendment increases the maximum annual dollar contribution limit for IRA contributions from $2,000 to $2,500 for 2002 through 2005, $3,000 for 2006 and 2007, $3,500 for 2008 and 2009, $4,000 for 2010, and $5,000 for 2011. After 2011, the limit is adjusted annually for inflation in $500 increments.

Additional catch-up contributions

The Senate amendment provides that individuals who have attained age 50 may make additional catch-up IRA contributions. The otherwise maximum contribution limit (before application of the AGI phase-out limits) for an individual who has attained age 50 before the end of the taxable year is increased by $500 for 2002 through 2005, $1,000 for 2006 through 2009, $1,500 for 2010, and $2,000 for 2011 and thereafter.

Deemed IRAs under employer plans

The Senate amendment provides that, if an eligible retirement plan permits employees to make voluntary employee contributions to a separate account or annuity that (1) is established under the plan, and (2) meets the requirements applicable to either traditional IRAs or Roth IRAs, then the separate account or annuity is deemed a traditional IRA or a Roth IRA, as applicable, for all purposes of the Code. For example, the reporting requirements applicable to IRAs apply. The deemed IRA, and contributions thereto, are not subject to the Code rules pertaining to the eligible retire-

ment plan. In addition, the deemed IRA, and contributions thereto, are not taken into account in applying such rules to any other contributions under the plan. The deemed IRA, and contributions thereto, are subject to the exclusive benefit and fiduciary rules of ERISA to the extent otherwise applicable to the plan, and are not subject to the ERISA reporting and disclosure, participation, vesting, funding, and enforcement requirements applicable to the eligible retirement plan.[57] An eligible retirement plan is a qualified plan (sec. 401(a)), tax-sheltered annuity (sec. 403(b)), or a governmental section 457 plan.

Tax-free IRA withdrawals for charitable purposes

The Senate amendment provides an exclusion from gross income for qualified charitable distributions from an IRA: (1) to a charitable organization (as described in sec. 170(c)) to which deductible contributions may be made; (2) to a charitable remainder annuity trust or charitable remainder unitrust; (3) to a pooled income fund (as defined in sec. 642(c)(5)); or (4) for the issuance of a charitable gift annuity. The exclusion applies with respect to distributions described in (2), (3), or (4) only if no person holds an income interest in the trust, fund, or annuity attributable to such distributions other than the IRA owner, his or her spouse, or a charitable organization.

In determining the character of distributions from a charitable remainder annuity trust or a charitable remainder unitrust to which a qualified charitable distribution from an IRA is made, the charitable remainder trust is required to treat as ordinary income the portion of the distribution from the IRA to the trust which would have been includible in income but for the Senate amendment, and as corpus any remaining portion of the distribution. Similarly, in determining the amount includible in gross income by reason of a payment from a charitable gift annuity purchased with a qualified charitable distribution from an IRA, the taxpayer is not permitted to treat the portion of the distribution from the IRA that would have been taxable but for the Senate amendment and that is used to purchase the annuity as an investment in the annuity contract.

A qualified charitable distribution is any distribution from an IRA that is made after age 70½, that qualifies as a charitable contribution (within the meaning of sec. 170(c)), and that is made directly to the charitable organization or to a charitable remainder annuity trust, charitable remainder unitrust, pooled income fund, or charitable gift annuity (as described above).[58] A taxpayer is not permitted to claim a charitable contribution deduction for amounts transferred from his or her IRA to a charity or to a trust, fund, or annuity that, because of the Senate amendment, are excluded from the taxpayer's income. Conversely, if the amounts transferred are

[57] The Senate amendment does not specify the treatment of deemed IRAs for purposes other than the Code and ERISA.

[58] It is intended that, in the case of transfer to a trust, fund, or annuity, the full amount distributed from an IRA will meet the definition of a qualified charitable distribution if the charitable organization's interest in the distribution would qualify as a charitable contribution under section 170.

otherwise nontaxable, e.g., a qualified distribution from a Roth IRA, the regularly applicable deduction rules apply.

Effective date.—The Senate amendment is generally effective for taxable years beginning after December 31, 2001. The provision relating to deemed IRAs under employer plans is effective for plan years beginning after December 31, 2002. The provision relating to tax-free IRA withdrawals for charitable purposes is effective for taxable years beginning after December 31, 2009.

CONFERENCE AGREEMENT

Increase in annual contribution limits

The conference agreement increases the maximum annual dollar contribution limit for IRA contributions from $2,000 to $3,000 for 2002 through 2004, $4,000 for 2005 through 2007, and $5,000 for 2008. After 2008, the limit is adjusted annually for inflation in $500 increments.

Additional catch-up contributions

The conference agreement provides that individuals who have attained age 50 may make additional catch-up IRA contributions. The otherwise maximum contribution limit (before application of the AGI phase-out limits) for an individual who has attained age 50 before the end of the taxable year is increased by $500 for 2002 through 2005, and $1,000 for 2006 and thereafter.

Deemed IRAs under employer plans

The conference agreement follows the Senate amendment.

Tax-free IRA withdrawals for charitable purposes

The conference agreement does not include the Senate amendment.

Effective date.—The conference agreement is generally effective for taxable years beginning after December 31, 2001. The provision relating to deemed IRAs under employer plans is effective for plan years beginning after December 31, 2002.

B. Pension Provisions

1. Expanding Coverage

(a) Increase in benefit and contribution limits (secs. 201 and 209 of the House bill, sec. 611 of the Senate amendment, and secs. 401(a)(17), 401(c)(2), 402(g), 408(p), 415 and 457 of the Code)

PRESENT LAW

In general

Present law imposes limits on contributions and benefits under qualified plans (sec. 415), the amount of compensation that may be taken into account under a plan for determining benefits (sec. 401(a)(17)), the amount of elective deferrals that an individual may make to a salary reduction plan or tax sheltered annuity (sec. 402(g)), and deferrals under an eligible deferred compensation plan

of a tax-exempt organization or a State or local government (sec. 457).

Limitations on contributions and benefits

Under present law, the limits on contributions and benefits under qualified plans are based on the type of plan. Under a defined contribution plan, the qualification rules limit the annual additions to the plan with respect to each plan participant to the lesser of (1) 25 percent of compensation or (2) $35,000 (for 2001). Annual additions are the sum of employer contributions, employee contributions, and forfeitures with respect to an individual under all defined contribution plans of the same employer. The $35,000 limit is indexed for cost-of-living adjustments in $5,000 increments.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation, or (2) $140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in $5,000 increments.

Under present law, in general, the dollar limit on annual benefits is reduced if benefits under the plan begin before the social security retirement age (currently, age 65) and increased if benefits begin after social security retirement age.

Compensation limitation

Under present law, the annual compensation of each participant that may be taken into account for purposes of determining contributions and benefits under a plan, applying the deduction rules, and for nondiscrimination testing purposes is limited to $170,000 (for 2001). The compensation limit is indexed for cost-of-living adjustments in $10,000 increments.

In general, contributions to qualified plans and IRAs are based on compensation. For a self-employed individual, compensation generally means net earnings subject to self-employment taxes ("SECA taxes"). Members of certain religious faiths may elect to be exempt from SECA taxes on religious grounds. Because the net earnings of such individuals are not subject to SECA taxes, these individuals are considered to have no compensation on which to base contributions to a retirement plan. Under an exception to this rule, net earnings of such individuals are treated as compensation for purposes of making contributions to an IRA.

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "section 401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,500 (for 2001). These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,500 (for 2001) or (2) 33⅓ percent of compensation. The $8,500 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

HOUSE BILL

Limits on contributions and benefits

The House bill increases the $35,000 limit on annual additions to a defined contribution plan to $40,000. This amount is indexed in $1,000 increments.[59]

The House bill increases the $140,000 annual benefit limit under a defined benefit plan to $160,000. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.[60] In adopting rules regarding the application of the increase in the defined benefit plan limits under the House bill, it is intended that the Secretary will apply rules similar to those adopted in Notice 99–44 regarding benefit increases due to the repeal of the combined plan limit under former section 415(e). Thus, for example, a defined benefit plan could provide for benefit increases to reflect the provisions of the House bill for a current or former employee who has commenced benefits under the plan prior to the effective date of the bill if the employee or former employee has an accrued benefit under the plan (other than an accrued benefit resulting from a benefit increase solely as a result of the increases in the section 415 limits under the bill). As under the notice, the maximum amount of permitted increase is generally the amount that could have been provided had the provisions of the House bill been in effect at the time of the commencement of benefit. In no case may benefits reflect increases that could not be paid prior to the effective date because of the limits in effect under present law. In addition, in no case may plan amendments providing increased benefits under the relevant provision of the House bill be effective prior to the effective date of the House bill.

Compensation limitation

The House bill increases the limit on compensation that may be taken into account under a plan to $200,000. This amount is indexed in $5,000 increments. The House bill also amends the definition of compensation for purposes of all qualified plans and IRAs (including SIMPLE arrangements) to include an individual's net

[59] The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the House bill.

[60] Another provision of the House bill modifies the defined benefit pension plan limits for multiemployer plans.

earnings that would be subject to SECA taxes but for the fact that the individual is covered by a religious exemption.

Elective deferral limitations

The House bill increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b) annuities and salary reduction SEPs to $11,000 in 2002. In 2003 and thereafter, the limits are increased in $1,000 annual increments until the limits reach $15,000 in 2006, with indexing in $500 increments thereafter. The House bill increases the maximum annual elective deferrals that may be made to a SIMPLE plan to $7,000 in 2002. In 2003 and thereafter, the SIMPLE plan deferral limit is increased in $1,000 annual increments until the limit reaches $10,000 in 2005. Beginning after 2005, the $10,000 dollar limit is indexed in $500 increments.

Section 457 plans

The House bill increases the dollar limit on deferrals under a section 457 plan to conform to the elective deferral limitation. Thus, the limit is $11,000 in 2002, and is increased in $1,000 annual increments thereafter until the limit reaches $15,000 in 2006. The limit is indexed thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[61]

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

Limits on contributions and benefits

The Senate amendment provides faster annual adjusting for inflation of the $35,000 limit on annual additions to a defined contribution plan. Under the Senate amendment this limit amount is adjusted annually for inflation in $1,000 increments.[62]

The Senate amendment increases the $140,000 annual benefit limit under a defined benefit plan to $150,000 for 2002 through 2004 and to $160,000 for 2005 and thereafter. The dollar limit is reduced for benefit commencement before age 62 and increased for benefit commencement after age 65.

Compensation limitation

The Senate amendment increases the limit on compensation that may be taken into account under a plan to $180,000 for 2002, $190,000 for 2003, and $200,000 for 2004 and 2005. After 2005, this amount is adjusted annually for inflation in $5,000 increments.

Elective deferral limitations

In 2002, the Senate amendment increases the dollar limit on annual elective deferrals under section 401(k) plans, section 403(b)

[61] Another provision of the House bill increases the 33⅓ percentage of compensation limit to 100 percent.

[62] The 25 percent of compensation limitation is increased to 100 percent of compensation under another provision of the Senate amendment.

annuities, and salary reduction SEPs to $11,000. In 2003 and thereafter, the limits increase in $500 annual increments until the limits reach $15,000 in 2010, with annual adjustments for inflation in $500 increments thereafter. The Senate amendment increases the maximum annual elective deferrals that may be made to a SIMPLE plan to $7,000 for 2002 and 2003, $8,000 for 2004 and 2005, $9,000 for 2006 and 2007, and $10,000 for 2008. After 2008, the $10,000 dollar limit is adjusted annually for inflation in $500 increments.

Section 457 plans

The dollar limit on deferrals under a section 457 plan is increased to $9,000 in 2002, and is increased in $500 annual increments thereafter until the limit reaches $11,000 in 2006. Beginning in 2007, the limit is increased in $1,000 annual increments until it reaches $15,000 in 2010. After 2010, the limit is adjusted annually for inflation thereafter in $500 increments. The limit is twice the otherwise applicable dollar limit in the three years prior to retirement.[63]

EFFECTIVE DATE

The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

Limits on contributions and benefits

The conference agreement follows the House bill.

Compensation limitation

The conference agreement follows the House bill.

Elective deferral limitations

The conference agreement follows the House bill.

Section 457 plans

The conference agreement follows the House bill.

Effective date.—The conference agreement generally is effective for years beginning after December 31, 2001. The provisions relating to defined benefit plans are effective for years ending after December 31, 2001.

(b) Plan loans for S corporation shareholders, partners, and sole proprietors (sec. 202 of the House bill, sec. 612 of the Senate amendment, and sec. 4975 of the Code)

PRESENT LAW

The Internal Revenue Code prohibits certain transactions ("prohibited transactions") between a qualified plan and a disqualified person in order to prevent persons with a close relationship to the qualified plan from using that relationship to the detriment of

[63] Another provision increases the 33⅓ percentage of compensation limit to 100 percent.

plan participants and beneficiaries.[64] Certain types of transactions are exempted from the prohibited transaction rules, including loans from the plan to plan participants, if certain requirements are satisfied. In addition, the Secretary of Labor can grant an administrative exemption from the prohibited transaction rules if the Secretary finds the exemption is administratively feasible, in the interest of the plan and plan participants and beneficiaries, and protective of the rights of participants and beneficiaries of the plan. Pursuant to this exemption process, the Secretary of Labor grants exemptions both with respect to specific transactions and classes of transactions.

The statutory exemptions to the prohibited transaction rules do not apply to certain transactions in which the plan makes a loan to an owner-employee.[65] Loans to participants other than owner-employees are permitted if loans are available to all participants on a reasonably equivalent basis, are not made available to highly compensated employees in an amount greater than made available to other employees, are made in accordance with specific provisions in the plan, bear a reasonable rate of interest, and are adequately secured. In addition, the Code places limits on the amount of loans and repayment terms.

For purposes of the prohibited transaction rules, an owner-employee means (1) a sole proprietor, (2) a partner who owns more than 10 percent of either the capital interest or the profits interest in the partnership, (3) an employee or officer of a Subchapter S corporation who owns more than five percent of the outstanding stock of the corporation, and (4) the owner of an individual retirement arrangement ("IRA"). The term owner-employee also includes certain family members of an owner-employee and certain corporations owned by an owner-employee.

Under the Internal Revenue Code, a two-tier excise tax is imposed on disqualified persons who engage in a prohibited transaction. The first level tax is equal to 15 percent of the amount involved in the transaction. The second level tax is imposed if the prohibited transaction is not corrected within a certain period, and is equal to 100 percent of the amount involved.

HOUSE BILL

The House bill generally eliminates the special present-law rules relating to plan loans made to an owner-employee (other than the owner of an IRA). Thus, the general statutory exemption applies to such transactions. Present law continues to apply with respect to IRAs.

Effective date.—The House bill is effective with respect to years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

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[64] Title I of the Employee Retirement Income Security Act of 1974, as amended ("ERISA"), also contains prohibited transaction rules. The Code and ERISA provisions are substantially similar, although not identical.

[65] Certain transactions involving a plan and S corporation shareholders are permitted.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment. The conferees intend that the Secretary of the Treasury and the Secretary of Labor will waive any penalty or excise tax in situations where a loan made prior to the effective date of the provision was exempt when initially made (treating any refinancing as a new loan) and the loan would have been exempt throughout the period of the loan if the provision had been in effect during the period of the loan.

(c) Modification of top-heavy rules (sec. 203 of the House bill, sec. 613 of the Senate amendment, and sec. 416 of the Code)

PRESENT LAW

In general

Under present law, additional qualification requirements apply to plans that primarily benefit an employer's key employees ("top-heavy plans"). These additional requirements provide (1) more rapid vesting for plan participants who are nonkey employees and (2) minimum nonintegrated employer contributions or benefits for plan participants who are non-key employees.

Definition of top-heavy plan

A defined benefit plan is a top-heavy plan if more than 60 percent of the cumulative accrued benefits under the plan are for key employees. A defined contribution plan is top heavy if the sum of the account balances of key employees is more than 60 percent of the total account balances under the plan. For each plan year, the determination of top-heavy status generally is made as of the last day of the preceding plan year ("the determination date").

For purposes of determining whether a plan is a top-heavy plan, benefits derived both from employer and employee contributions, including employee elective contributions, are taken into account. In addition, the accrued benefit of a participant in a defined benefit plan and the account balance of a participant in a defined contribution plan includes any amount distributed within the five-year period ending on the determination date.

An individual's accrued benefit or account balance is not taken into account in determining whether a plan is top-heavy if the individual has not performed services for the employer during the five-year period ending on the determination date.

In some cases, two or more plans of a single employer must be aggregated for purposes of determining whether the group of plans is top-heavy. The following plans must be aggregated: (1) plans which cover a key employee (including collectively bargained plans); and (2) any plan upon which a plan covering a key employee depends for purposes of satisfying the Code's nondiscrimination rules. The employer may be required to include terminated plans in the required aggregation group. In some circumstances, an employer may elect to aggregate plans for purposes of determining whether they are top heavy.

SIMPLE plans are not subject to the top-heavy rules.

Definition of key employee

A key employee is an employee who, during the plan year that ends on the determination date or any of the four preceding plan years, is (1) an officer earning over one-half of the defined benefit plan dollar limitation of section 415 ($70,000 for 2001), (2) a five-percent owner of the employer, (3) a one-percent owner of the employer earning over $150,000, or (4) one of the 10 employees earning more than the defined contribution plan dollar limit ($35,000 for 2001) with the largest ownership interests in the employer. A family ownership attribution rule applies to the determination of one-percent owner status, five-percent owner status, and largest ownership interest. Under this attribution rule, an individual is treated as owning stock owned by the individual's spouse, children, grandchildren, or parents.

Minimum benefit for non-key employees

A minimum benefit generally must be provided to all non-key employees in a top-heavy plan. In general, a top-heavy defined benefit plan must provide a minimum benefit equal to the lesser of (1) two percent of compensation multiplied by the employee's years of service, or (2) 20 percent of compensation. A top-heavy defined contribution plan must provide a minimum annual contribution equal to the lesser of (1) three percent of compensation, or (2) the percentage of compensation at which contributions were made for key employees (including employee elective contributions made by key employees and employer matching contributions).

For purposes of the minimum benefit rules, only benefits derived from employer contributions (other than amounts employees have elected to defer) to the plan are taken into account, and an employee's social security benefits are disregarded (i.e., the minimum benefit is nonintegrated). Employer matching contributions may be used to satisfy the minimum contribution requirement; however, in such a case the contributions are not treated as matching contributions for purposes of applying the special nondiscrimination requirements applicable to employee elective contributions and matching contributions under sections 401(k) and (m). Thus, such contributions would have to meet the general nondiscrimination test of section 401(a)(4).[66]

Top-heavy vesting

Benefits under a top-heavy plan must vest at least as rapidly as under one of the following schedules: (1) three-year cliff vesting, which provides for 100 percent vesting after three years of service; and (2) two-six year graduated vesting, which provides for 20 percent vesting after two years of service, and 20 percent more each year thereafter so that a participant is fully vested after six years of service.[67]

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[66] Treas. Reg. sec. 1.416–1 Q&A M–19.

[67] Benefits under a plan that is not top heavy must vest at least as rapidly as under one of the following schedules: (1) five-year cliff vesting; and (2) three-seven year graded vesting, which provides for 20 percent vesting after three years and 20 percent more each year thereafter so that a participant is fully vested after seven years of service.

Qualified cash or deferred arrangements

Under a qualified cash or deferred arrangement (a "section 401(k) plan"), an employee may elect to have the employer make payments as contributions to a qualified plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals. A special nondiscrimination test applies to elective deferrals under cash or deferred arrangements, which compares the elective deferrals of highly compensated employees with elective deferrals of nonhighly compensated employees. (This test is called the actual deferral percentage test or the "ADP" test). Employer matching contributions under qualified defined contribution plans are also subject to a similar nondiscrimination test. (This test is called the actual contribution percentage test or the "ACP" test.)

Under a design-based safe harbor, a cash or deferred arrangement is deemed to satisfy the ADP test if the plan satisfies one of two contribution requirements and satisfies a notice requirement. A plan satisfies the contribution requirement under the safe harbor rule for qualified cash or deferred arrangements if the employer either (1) satisfies a matching contribution requirement or (2) makes a nonelective contribution to a defined contribution plan of at least three percent of an employee's compensation on behalf of each nonhighly compensated employee who is eligible to participate in the arrangement without regard to the permitted disparity rules (sec. 401(1)). A plan satisfies the matching contribution requirement if, under the arrangement: (1) the employer makes a matching contribution on behalf of each nonhighly compensated employee that is equal to (a) 100 percent of the employee's elective deferrals up to three percent of compensation and (b) 50 percent of the employee's elective deferrals from three to five percent of compensation; and (2), the rate of match with respect to any elective contribution for highly compensated employees is not greater than the rate of match for nonhighly compensated employees. Matching contributions that satisfy the design-based safe harbor for cash or deferred arrangements are deemed to satisfy the ACP test. Certain additional matching contributions are also deemed to satisfy the ACP test.

HOUSE BILL

Definition of top-heavy plan

The House bill provides that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan. Matching or nonelective contributions provided under such a plan may be taken into account in satisfying the minimum contribution requirements applicable to top-heavy plans.[68]

In determining whether a plan is top-heavy, distributions during the year ending on the date the top-heavy determination is being made are taken into account. The present-law five-year rule

[68] This provision is not intended to preclude the use of nonelective contributions that are used to satisfy the safe harbor rules from being used to satisfy other qualified retirement plan nondiscrimination rules, including those involving cross-testing.

applies with respect to in-service distributions. Similarly, the House bill provides that an individual's accrued benefit or account balance is not taken into account if the individual has not performed services for the employer during the one-year period ending on the date the top-heavy determination is being made.

Definition of key employee

The House bill (1) provides that an employee is not considered a key employee by reason of officer status unless the employee earns more than $150,000 and (2) repeals the top-10 owner key employee category. The House bill repeals the four-year lookback rule for determining key employee status and provides that an employee is a key employee only if he or she is a key employee during the preceding plan year.

Thus, under the House bill, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of $150,000, (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of $150,000. The present-law limits on the number of officers treated as key employees under (1) continue to apply.

The family ownership attribution rule no longer applies in determining whether an individual is a five-percent owner of the employer for purposes of the top-heavy rules only. The family ownership attribution rule continues to apply to other provisions that cross reference the top-heavy rules, such as the definition of highly compensated employee and the definition of one-percent owner under the top-heavy rules.

Minimum benefit for nonkey employees

Under the House bill, matching contributions are taken into account in determining whether the minimum benefit requirement has been satisfied.[69]

The House bill provides that, in determining the minimum benefit required under a defined benefit plan, a year of service does not include any year in which no key employee or former key employee benefits under the plan (as determined under sec. 410).

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

Under the Senate amendment, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of $85,000 (for 2001), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of $150,000. The present-law limits on the number of officers treated as key employees under (1) continue to apply. An employee who was not an employee in the preceding plan year, or who was an employee only for part of the year, is treated as a key employee if

[69] Thus, this provision overrides the provision in Treasury regulations that, if matching contributions are used to satisfy the minimum benefit requirement, then they are not treated as matching contributions for purposes of the section 401(m) nondiscrimination rules.

it can be reasonably anticipated that the employee will meet the definition of a key employee for the current plan year.

Under the Senate amendment, the family ownership attribution rule continues to apply in determining whether an individual is a five-percent owner of the employer for purposes of the top-heavy rules. In addition, the Senate amendment does not provide that a plan consisting of a cash-or-deferred arrangement that satisfies the design-based safe harbor for such plans and matching contributions that satisfy the safe harbor rule for such contributions is not a top-heavy plan.

Effective date.—The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications.

Under the conference agreement, an employee is considered a key employee if, during the prior year, the employee was (1) an officer with compensation in excess of $130,000 (adjusted for inflation in $5,000 increments), (2) a five-percent owner, or (3) a one-percent owner with compensation in excess of $150,000. The present-law limits on the number of officers treated as key employees under (1) continue to apply.

Under the conference agreement, the family ownership attribution rule continues to apply in determining whether an individual is a five-percent owner of the employer for purposes of the top-heavy rules.

Effective date.—The conference agreement is effective for years beginning after December 31, 2001.

(d) Elective deferrals not taken into account for purposes of deduction limits (sec. 204 of the House bill, sec. 614 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the

year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

For purposes of the deduction limits, employee elective deferral contributions to a section 401(k) plan are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.

Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

HOUSE BILL

Under the House bill, elective deferral contributions are not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account elective deferral contributions.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification.

Under the Senate amendment, the applicable percentage of elective deferral contributions is not subject to the deduction limits, and the application of a deduction limitation to any other employer contribution to a qualified retirement plan does not take into account the applicable percentage of elective deferral contributions. The applicable percentage is 25 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

(e) Repeal of coordination requirements for deferred compensation plans of state and local governments and tax-exempt organizations (sec. 205 of the House bill, sec. 615 of the Senate amendment, and sec. 457 of the Code)

PRESENT LAW

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local government employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,500 (in 2001) or (2) 33⅓ percent of compensation. The $8,500 limit is increased for inflation in $500 increments. Under a special catch-up rule, a section 457 plan may provide that, for one or more of the participant's last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

The $8,500 limit (as modified under the catch-up rule), applies to all deferrals under all section 457 plans in which the individual participates. In addition, in applying the $8,500 limit, contributions

under a tax-sheltered annuity ("section 403(b) annuity"), elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), salary reduction contributions under a simplified employee pension plan ("SEP"), and contributions under a SIMPLE plan are taken into account. Further, the amount deferred under a section 457 plan is taken into account in applying a special catch-up rule for section 403(b) annuities.

HOUSE BILL

The House bill repeals the rules coordinating the section 457 dollar limit with contributions under other types of plans.[70]

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(f) Eliminate IRS user fees for certain determination letter requests regarding employer plans (sec. 206 of the House bill and sec. 621 of the Senate amendment)

PRESENT LAW

An employer that maintains a retirement plan for the benefit of its employees may request from the IRS a determination as to whether the form of the plan satisfies the requirements applicable to tax-qualified plans (sec. 401(a)). In order to obtain from the IRS a determination letter on the qualified status of the plan, the employer must pay a user fee. The Secretary determines the user fee applicable for various types of requests, subject to statutory minimum requirements for average fees based on the category of the request. The user fee may range from $125 to $1,250, depending upon the scope of the request and the type and format of the plan.[71]

Present law provides that plans that do not meet the qualification requirements will be treated as meeting such requirements if appropriate retroactive plan amendments are made during the remedial amendment period. In general, the remedial amendment period ends on the due date for the employer's tax return (including extensions) for the taxable year in which the event giving rise to the disqualifying provision occurred (e.g., a plan amendment or a change in the law). The Secretary may provide for general extensions of the remedial amendment period or for extensions in certain cases. For example, the remedial amendment period with respect

[70] The limits on deferrals under a section 457 plan are modified under other provisions of the House bill.

[71] Authorization for the user fees was originally enacted in section 10511 of the Revenue Act of 1987 (Pub. L. No. 100–203, December 22, 1987). The authorization was extended through September 30, 2003, by Public Law Number 104–117 (An Act to provide that members of the Armed Forces performing services for the peacekeeping efforts in Bosnia and Herzegovina, Croatia, and Macedonia shall be entitled to tax benefits in the same manner as if such services were performed in a combat zone, and for other purposes (March 20, 1996)).

to amendments relating to the qualification requirements affected by the General Agreements on Tariffs and Trade, the Uniformed Services Employment and Reemployment Rights Act of 1994, the Small Business Job Protection Act of 1996, the Taxpayer Relief Act of 1997, and the Internal Revenue Service Restructuring and Reform Act of 1998 generally ends the last day of the first plan year beginning on or after January 1, 2001.[72]

HOUSE BILL

A small employer (100 or fewer employees) is not required to pay a user fee for a determination letter request with respect to the qualified status of a retirement plan that the employer maintains if the request is made before the later of (1) the last day of the fifth plan year of the plan or (2) the end of any applicable remedial amendment period with respect to the plan that begins before the end of the fifth plan year of the plan. In addition, determination letter requests for which user fees are not required under the House bill are not taken into account in determining average user fees. The House bill applies only to requests by employers for determination letters concerning the qualified retirement plans they maintain. Therefore, a sponsor of a prototype plan is required to pay a user fee for a request for a notification letter, opinion letter, or similar ruling. A small employer that adopts a prototype plan, however, is not required to pay a user fee for a determination letter request with respect to the employer's plan.

Effective date.—The House bill is effective for determination letter requests made after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications. An eligible employer is not required to pay a user fee for a ruling letter, opinion letter, determination letter, or similar request with respect to the qualified status of a new retirement plan that the employer maintains and with respect to which the employer has not previously made a request. An employer is eligible under the Senate amendment if (1) the employer has no more than 100 employees, (2) the employer has at least one nonhighly compensated employee who is participating in the plan, and (3) during the three-taxable year period immediately preceding the taxable year in which the request is made, neither the employer nor a related employer established or maintained a qualified plan with respect to which contributions were made or benefits were accrued for substantially the same employees covered under the plan with respect to which the request is made.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modification. An employer is eligible under the conference agreement if the employer has no more than 100 employees and has at least one nonhighly compensated employee who is participating in the plan.

[72] Rev. Proc. 2000–27, 2000–26 I.R.B. 1272.

(g) Deduction limits (sec. 207 of the House bill, sec. 616 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

Employer contributions to one or more qualified retirement plans are deductible subject to certain limits. In general, the deduction limit depends on the kind of plan. Subject to certain exceptions, nondeductible contributions are subject to a 10-percent excise tax.

In the case of a defined benefit pension plan or a money purchase pension plan, the employer generally may deduct the amount necessary to satisfy the minimum funding cost of the plan for the year. If a defined benefit pension plan has more than 100 participants, the maximum amount deductible is at least equal to the plan's unfunded current liabilities.

In some cases, the amount of deductible contributions is limited by compensation. In the case of a profit-sharing or stock bonus plan, the employer generally may deduct an amount equal to 15 percent of compensation of the employees covered by the plan for the year.

If an employer sponsors both a defined benefit pension plan and a defined contribution plan that covers some of the same employees (or a money purchase pension plan and another kind of defined contribution plan), the total deduction for all plans for a plan year generally is limited to the greater of (1) 25 percent of compensation or (2) the contribution necessary to meet the minimum funding requirements of the defined benefit pension plan for the year (or the amount of the plan's unfunded current liabilities, in the case of a plan with more than 100 participants).

In the case of an employee stock ownership plan ("ESOP"), principal payments on a loan used to acquire qualifying employer securities are deductible up to 25 percent of compensation.

For purposes of the deduction limits, employee elective deferral contributions to a qualified cash or deferred arrangement ("section 401(k) plan") are treated as employer contributions and, thus, are subject to the generally applicable deduction limits.[73]

For purposes of the deduction limits, compensation means the compensation otherwise paid or accrued during the taxable year to the beneficiaries under the plan, and the beneficiaries under a profit-sharing or stock bonus plan are the employees who benefit under the plan with respect to the employer's contribution.[74] An employee who is eligible to make elective deferrals under a section 401(k) plan is treated as benefitting under the arrangement even if the employee elects not to defer.[75]

For purposes of the deduction rules, compensation generally includes only taxable compensation, and thus does not include salary reduction amounts, such as elective deferrals under a section 401(k) plan or a tax-sheltered annuity ("section 403(b) annuity"), elective contributions under a deferred compensation plan of a tax-exempt organization or a State or local government ("section 457

[73] Another provision of the House bill provides that elective deferrals are not subject to the deduction limits.

[74] Rev. Rul. 65–295, 1965–2 C.B. 148.

[75] Treas. Reg. sec. 1.410(b)–3.

plan"), and salary reduction contributions under a section 125 cafeteria plan. For purposes of the contribution limits under section 415, compensation does include such salary reduction amounts.

HOUSE BILL

Under the House bill, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan is increased from 15 percent to 20 percent of compensation of the employees covered by the plan for the year.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

Under the Senate amendment, the definition of compensation for purposes of the deduction rules includes salary reduction amounts treated as compensation under section 415. In addition, the annual limitation on the amount of deductible contributions to a profit-sharing or stock bonus plan is increased from 15 percent to 25 percent of compensation of the employees covered by the plan for the year. Also, except to the extent provided in regulations, a money purchase pension plan is treated like a profit-sharing or stock bonus plan for purposes of the deduction rules.

Effective date.—The Senate amendment is effective for years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

(h) Option to treat elective deferrals as after-tax contributions (sec. 208 of the bill, sec. 617 of the Senate amendment, and new sec. 402A of the Code)

PRESENT LAW

A qualified cash or deferred arrangement ("section 401(k) plan") or a tax-sheltered annuity ("section 403(b) annuity") may permit a participant to elect to have the employer make payments as contributions to the plan or to the participant directly in cash. Contributions made to the plan at the election of a participant are elective deferrals. Elective deferrals must be nonforfeitable and are subject to an annual dollar limitation (sec. 402(g)) and distribution restrictions. In addition, elective deferrals under a section 401(k) plan are subject to special nondiscrimination rules. Elective deferrals (and earnings attributable thereto) are not includible in a participant's gross income until distributed from the plan.

Elective deferrals for a taxable year that exceed the annual dollar limitation ("excess deferrals") are includible in gross income for the taxable year. If an employee makes elective deferrals under a plan (or plans) of a single employer that exceed the annual dollar limitation ("excess deferrals"), then the plan may provide for the distribution of the excess deferrals, with earnings thereon. If the excess deferrals are made to more than one plan of unrelated em-

ployers, then the plan may permit the individual to allocate excess deferrals among the various plans, no later than the March 1 (April 15 under the applicable regulations) following the end of the taxable year. If excess deferrals are distributed not later than April 15 following the end of the taxable year, along with earnings attributable to the excess deferrals, then the excess deferrals are not again includible in income when distributed. The earnings are includible in income in the year distributed. If excess deferrals (and income thereon) are not distributed by the applicable April 15, then the excess deferrals (and income thereon) are includible in income when received by the participant. Thus, excess deferrals that are not distributed by the applicable April 15th are taxable both in the taxable year when the deferral was made and in the year the participant receives a distribution of the excess deferral.

Individuals with adjusted gross income below certain levels generally may make nondeductible contributions to a Roth IRA and may convert a deductible or nondeductible IRA into 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 (1) is made after the five-taxable year period beginning with the first taxable year for which the individual made a contribution to a Roth IRA, and (2) is made after attainment of age 59½, is made on account of death or disability, or is a qualified special purpose distribution (i.e., for first-time homebuyer expenses of up to $10,000). A distribution from a Roth IRA that is not a qualified distribution is includible in income to the extent attributable to earnings, and is subject to the 10-percent tax on early withdrawals (unless an exception applies).[76]

HOUSE BILL

A section 401(k) plan or a section 403(b) annuity is permitted to include a "qualified plus contribution program" that permits a participant to elect to have all or a portion of the participant's elective deferrals under the plan treated as designated plus contributions. Designated plus contributions are elective deferrals that the participant designates (at such time and in such manner as the Secretary may prescribe)[77] as not excludable from the participant's gross income.

The annual dollar limitation on a participant's designated plus contributions is the section 402(g) annual limitation on elective deferrals, reduced by the participant's elective deferrals that the participant does not designate as designated plus contributions. Designated plus contributions are treated as any other elective deferral for purposes of nonforfeitability requirements and distribution restrictions.[78] Under a section 401(k) plan, designated plus contribu-

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

[77] It is intended that the Secretary will generally not permit retroactive designations of elective deferrals as designated plus contributions.

[78] Similarly, designated plus contributions to a section 403(b) annuity are treated the same as other salary reduction contributions to the annuity (except that designated plus contributions are includible in income).

tions also are treated as any other elective deferral for purposes of the special nondiscrimination requirements.[79]

The plan is required to establish a separate account, and maintain separate recordkeeping, for a participant's designated plus contributions (and earnings allocable thereto). A qualified distribution from a participant's designated plus contributions account is not includible in the participant's gross income. A qualified distribution is a distribution that is made after the end of a specified nonexclusion period and that is (1) made on or after the date on which the participant attains age 59½, (2) made to a beneficiary (or to the estate of the participant) on or after the death of the participant, or (3) attributable to the participant's being disabled.[80] The nonexclusion period is the five-year-taxable period beginning with the earlier of (1) the first taxable year for which the participant made a designated plus contribution to any designated plus contribution account established for the participant under the plan, or (2) if the participant has made a rollover contribution to the designated plus contribution account that is the source of the distribution from a designated plus contribution account established for the participant under another plan, the first taxable year for which the participant made a designated plus contribution to the previously established account.

A distribution from a designated plus contributions account that is a corrective distribution of an elective deferral (and income allocable thereto) that exceeds the section 402(g) annual limit on elective deferrals or a corrective distribution of an excess contribution under the special nondiscrimination rules (pursuant to sec. 401(k)(8) (and income allocable thereto) is not a qualified distribution. In addition, the treatment of excess designated plus contributions is similar to the treatment of excess deferrals attributable to non-designated plus contributions. If excess designated plus contributions (including earnings thereon) are distributed no later than the April 15th following the taxable year, then the designated plus contributions is not includible in gross income as a result of the distribution, because such contributions are includible in gross income when made. Earnings on such excess designated plus contributions are treated the same as earnings on excess deferrals distributed no later than April 15th, i.e., they are includible in income when distributed. If excess designated plus contributions are not distributed no later than the applicable April 15th, then such contributions (and earnings thereon) are taxable when distributed. Thus, as is the case with excess elective deferrals that are not distributed by the applicable April 15th, the contributions are includible in income in the year when made and again when distributed from the plan. Earnings on such contributions are taxable when received.

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[79] It is intended that the Secretary provide ordering rules regarding the return of excess contributions under the special nondiscrimination rules (pursuant to sec. 401(k)(8)) in the event a participant makes both regular elective deferrals and designated plus contributions. It is intended that such rules will generally permit a plan to allow participants to designate which contributions are returned first or to permit the plan to specify which contributions are returned first. It is also intended that the Secretary will provide ordering rules to determine the extent to which a distribution consists of excess Roth contributions.

[80] A qualified special purpose distribution, as defined under the rules relating to Roth IRAs, does not qualify as a tax-free distribution from a designated plus contributions account.

A participant is permitted to roll over a distribution from a designated plus contributions account only to another designated plus contributions account or a Roth IRA of the participant.

The Secretary of the Treasury is directed to require the plan administrator of each section 401(k) plan or section 403(b) annuity that permits participants to make designated plus contributions to make such returns and reports regarding designated plus contributions to the Secretary, plan participants and beneficiaries, and other persons that the Secretary may designate.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, except that the Senate amendment refers to designated plus contributions as "Roth contributions."

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2003.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with a modification of the effective date.

Effective date.—The conference agreement is effective for taxable years beginning after December 31, 2005.

(i) Certain nonresident aliens excluded in applying minimum coverage requirements (sec. 210 of the House bill, sec. 622 of the Senate amendment, and secs. 410(b)(3) and 861(a)(3) of the Code)

PRESENT LAW

Under the minimum coverage requirements (sec. 410(b)), a qualified plan must benefit a minimum number of the employer's nonhighly compensated employees. In applying the minimum coverage requirements, employees who are nonresident aliens are disregarded if they have no earned income from sources within the United States ("U.S. source income").

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 (including the minimum coverage and nondiscrimination requirements applicable to such plans), employer-provided group-term life insurance, or employer-provided accident and health plans. As a result, such compensation is treated as U.S. source income for purposes of such plans, including the application of the qualified retirement plan minimum coverage and nondiscrimination requirements. As a result, such nonresident aliens must be taken into account in deter-

mining whether the plan satisfies the minimum coverage requirements.

HOUSE BILL

For purposes of the application of the minimum coverage requirements (sec. 410(b)), 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. As a result, such nonresident aliens are excluded from consideration in the application of the minimum coverage requirements.

Effective date.—The House bill is effective with respect to plan years beginning after December 31, 2001.

SENATE AMENDMENT

Under the Senate amendment, the special rule relating to compensation 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 compensation is extended in order to apply for purposes of qualified retirement plans, employer-provided group-term life insurance, and employer-provided accident and health plans. Therefore, such compensation is not treated as U.S. source income for any purpose under such plans, including the application of the qualified retirement plan minimum coverage and nondiscrimination requirements.

Effective date.—The Senate amendment is effective with respect to plan years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

(j) Nonrefundable credit to certain individuals for elective deferrals and IRA contributions (sec. 618 of the Senate amendment and new sec. 25B of the Code)

PRESENT LAW

Present law provides favorable tax treatment for a variety of retirement savings vehicles, including employer-sponsored retirement plans and individual retirement arrangements ("IRAs").

Several different types of tax-favored employer-sponsored retirement plans exist, such as section 401(a) qualified plans (including plans with a section 401(k) qualified cash-or-deferred arrangement), section 403(a) qualified annuity plans, section 403(b) annuities, section 408(k) simplified employee pensions ("SEPs"), section 408(p) SIMPLE retirement accounts, and section 457(b) eligible deferred compensation plans. In general, an employer and, in certain cases, employees, contribute to the plan. Taxation of the contributions and earnings thereon is generally deferred until benefits are

distributed from the plan to participants or their beneficiaries.[81] Contributions and benefits under tax-favored employer-sponsored retirement plans are subject to specific limitations.

Coverage and nondiscrimination rules also generally apply to tax-favored employer-sponsored retirement plans to ensure that plans do not disproportionately cover higher-paid employees and that benefits provided to moderate- and lower-paid employees are generally proportional to those provided to higher-paid employees.

IRAs include both traditional IRAs and Roth IRAs. In general, an individual makes contributions to an IRA, and investment earnings on those contributions accumulate on a tax-deferred basis. Total annual IRA contributions per individual are limited to $2,000 (or the compensation of the individual or the individual's spouse, if smaller). Contributions to a traditional IRA may be deducted from gross income if an individual's adjusted gross income ("AGI") is below certain levels or the individual is not an active participant in certain employer-sponsored retirement plans. Contributions to a Roth IRA are not deductible from gross income, regardless of adjusted gross income. A distribution from a traditional IRA is includible in the individual's gross income except to the extent of individual contributions made on a nondeductible basis. A qualified distribution from a Roth IRA is excludable from gross income.

Taxable distributions made from employer retirement plans and IRAs before the employee or individual has reached age 59½ are subject to a 10-percent additional tax, unless an exception applies.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a temporary nonrefundable tax credit for contributions made by eligible taxpayers to a qualified plan. The maximum annual contribution eligible for the credit is $2,000. The credit rate depends on the adjusted gross income ("AGI") of the taxpayer. Only joint returns with AGI of $50,000 or less, head of household returns of $37,500 or less, and single returns of $25,000 or less are eligible for the credit. The AGI limits applicable to single taxpayers apply to married taxpayers filing separate returns. The credit is in addition to any deduction or exclusion that would otherwise apply with respect to the contribution. The credit offsets minimum tax liability as well as regular tax liability. The credit is available to individuals who are 18 or over, other than individuals who are full-time students or claimed as a dependent on another taxpayer's return.

The credit is available with respect to elective contributions to a section 401(k) plan, section 403(b) annuity, or eligible deferred compensation arrangement of a State or local government (a "sec. 457 plan"), SIMPLE, or SEP, contributions to a traditional or Roth IRA, and voluntary after-tax employee contributions to a qualified retirement plan. The present-law rules governing such contributions continue to apply.

[81] In the case of after-tax employee contributions, only earnings are taxed upon withdrawal.

The amount of any contribution eligible for the credit is reduced by taxable distributions received by the taxpayer and his or her spouse from any savings arrangement described above or any other qualified retirement plan during the taxable year for which the credit is claimed, the two taxable years prior to the year the credit is claimed, and during the period after the end of the taxable year and prior to the due date for filing the taxpayer's return for the year. In the case of a distribution from a Roth IRA, this rule applies to any such distributions, whether or not taxable.

The credit rates based on AGI are as follows.

Joint filers	Heads of households	All other filers	Credit rate
$0-$30,000	$0-$22,500	$0-$15,000	50 percent
$30,000-$32,500	$22,500-$24,375	$15,000-$16,250	20 percent
$32,500-$50,000	$24,375-$37,500	$16,250-$25,000	10 percent
Over $50,000	Over $37,500	Over $25,000	0 percent

The Senate amendment directs the Secretary of the Treasury to report annually to the Senate Finance Committee and the House Committee on Ways and Means regarding the number of individuals who claim the credit.

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

(k) Small business tax credit for qualified retirement plan contributions (sec. 619 of the Senate amendment and new sec. 45E of the Code)

PRESENT LAW

The timing of an employer's deduction for compensation paid to an employee generally corresponds to the employee's recognition of the compensation. However, an employer that contributes to a qualified retirement plan is entitled to a deduction (within certain limits) for the employer's contribution to the plan on behalf of an employee even though the employee does not recognize income with respect to the contribution until the amount is distributed to the employee.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a nonrefundable income tax credit for small employers equal to 50 percent of certain qualifying employer contributions made to qualified retirement plans on behalf of nonhighly compensated employees. The credit is not available with respect to contributions to a SIMPLE IRA or SEP. For purposes of the Senate amendment, a small employer means an employer with no more than 20 employees who received at least $5,000 of earnings in the preceding year. A nonhighly compensated

employee is defined as an employee who neither (1) was a five-percent owner of the employer at any time during the current year or the preceding year, or (2) for the preceding year, had compensation in excess of $80,000 (adjusted annually for inflation, this amount is $85,000 for 2001).[82] The credit is available for the first three plan years of the plan.[83]

The Senate amendment requires a small employer to make nonelective contributions equal to at least one percent of compensation to qualify for the credit. The credit applies to both qualifying nonelective employer contributions and qualifying employer matching contributions, but only up to a total of three percent of the nonhighly compensated employee's compensation. The credit is available for 50 percent of qualifying benefit accruals under a nonintegrated defined benefit plan if the benefits are equivalent, as defined in regulations, to a three-percent nonelective contribution to a defined contribution plan.

To qualify for the credit, the nonelective and matching contributions to a defined contribution plan and the benefit accruals under a defined benefit plan are required to vest at least as rapidly as under either a three-year cliff vesting schedule or a graded schedule that provides 20-percent vesting per year for the first five years. In order to qualify for the credit, contributions to plans other than pension plans must be subject to the same distribution restrictions that apply to qualified nonelective employer contributions to a section 401(k) plan, i.e., distribution only upon separation from service, death, disability, attainment of age 59½, plan termination without a successor plan, or acquisition of a subsidiary or substantially all the assets of a trade or business that employs the participant.[84] Qualifying contributions to pension plans are subject to the distribution restrictions applicable to such plans.

A defined contribution plan to which the small employer makes the qualifying contributions (and any plan aggregated with that plan for nondiscrimination testing purposes) is required to allocate any nonelective employer contributions proportionally to participants' compensation from the employer (or on a flat-dollar basis) and, accordingly, without the use of permitted disparity or cross-testing. An equivalent requirement must be met with respect to a defined benefit plan.

Forfeited nonvested qualifying contributions or accruals for which the credit was claimed generally result in recapture of the credit at a rate of 35 percent. However, recapture does not apply to the extent that forfeitures of contributions are reallocated to nonhighly compensated employees or applied to future contributions on behalf of nonhighly compensated employees. The Secretary

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[82] The top paid group election, which under present law permits an employer to classify an employee as a nonhighly compensated employee if the employee had compensation in excess of $80,000 (adjusted annually for inflation) during the preceding year but was not among the top 20 percent of employees of the employer when ranked on the basis of compensation paid to employees during the preceding year, is not taken into account in determining nonhighly compensated employees for purposes of the Senate amendment.

[83] The credit only applies if the employer has not had another qualified retirement plan in the prior three taxable years with respect to which contributions or accruals were made for substantially the same employees. It is intended that a plan will be for substantially the same employees if half or more of the employees for whom contributions or accruals are made under the new plan are employees for whom contributions or accruals were made under a prior plan.

[84] The rules relating to distribution upon separation from service are modified under another provision of the Senate amendment.

of the Treasury is authorized to issue administrative guidance, including de minimis rules, to simplify or facilitate claiming and recapturing the credit.

The credit is a general business credit.[85] The 50 percent of qualifying contributions that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying contributions (and other contributions) are deductible to the extent permitted under present law.

Effective date.—The Senate amendment is effective with respect to contributions paid or incurred in taxable years beginning after December 31, 2002.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment.

(l) Small business tax credit for new retirement plan expenses (sec. 620 of the Senate amendment and new sec. 45E of the Code)

PRESENT LAW

The costs incurred by an employer related to the establishment and maintenance of a retirement plan (e.g., payroll system changes, investment vehicle set-up fees, consulting fees) generally are deductible by the employer as ordinary and necessary expenses in carrying on a trade or business.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides a nonrefundable income tax credit for 50 percent of the administrative and retirement-education expenses for any small business that adopts a new qualified defined benefit or defined contribution plan (including a section 401(k) plan), SIMPLE plan, or simplified employee pension ("SEP"). The credit applies to 50 percent of the first $1,000 in administrative and retirement-education expenses for the plan for each of the first three years of the plan.

The credit is available to an employer that did not employ, in the preceding year, more than 100 employees with compensation in excess of $5,000. In order for an employer to be eligible for the credit, the plan must cover at least one nonhighly compensated employee. In addition, if the credit is for the cost of a payroll deduction IRA arrangement, the arrangement must be made available to all employees of the employer who have worked with the employer for at least three months.

The credit is a general business credit.[86] The 50 percent of qualifying expenses that are effectively offset by the tax credit are not deductible; the other 50 percent of the qualifying expenses (and

[85] The credit cannot be carried back to years before the effective date.
[86] The credit cannot be carried back to years before the effective date.

other expenses) are deductible to the extent permitted under present law.

Effective date.—The Senate amendment is effective with respect to costs paid or incurred in taxable years beginning after December 31, 2001, with respect to plans established after such date.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

2. Enhancing Fairness for Women

(a) Additional salary reduction catch-up contributions (sec. 301 of the House bill, sec. 631 of the Senate amendment, and sec. 414 of the Code)

PRESENT LAW

Elective deferral limitations

Under present law, under certain salary reduction arrangements, an employee may elect to have the employer make payments as contributions to a plan on behalf of the employee, or to the employee directly in cash. Contributions made at the election of the employee are called elective deferrals.

The maximum annual amount of elective deferrals that an individual may make to a qualified cash or deferred arrangement (a "401(k) plan"), a tax-sheltered annuity ("section 403(b) annuity") or a salary reduction simplified employee pension plan ("SEP") is $10,500 (for 2001). The maximum annual amount of elective deferrals that an individual may make to a SIMPLE plan is $6,500 (for 2001). These limits are indexed for inflation in $500 increments.

Section 457 plans

The maximum annual deferral under a deferred compensation plan of a State or local government or a tax-exempt organization (a "section 457 plan") is the lesser of (1) $8,500 (for 2001) or (2) 33⅓ percent of compensation. The $8,500 dollar limit is increased for inflation in $500 increments. Under a special catch-up rule, the section 457 plan may provide that, for one or more of the participant's last three years before retirement, the otherwise applicable limit is increased to the lesser of (1) $15,000 or (2) the sum of the otherwise applicable limit for the year plus the amount by which the limit applicable in preceding years of participation exceeded the deferrals for that year.

HOUSE BILL

The House bill provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan are increased for individuals who have attained age 50 by the end of the year.[87] Additional contributions are permitted by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise

[87] Another provision of the House bill increases the dollar limit on elective deferrals under such arrangements.

be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the House bill, the additional amount of elective contributions that are permitted to be made by an eligible individual participating in such a plan is the lesser of (1) $5,000, or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year. This $5,000 amount is indexed for inflation in $500 increments in 2007 and thereafter.[88]

Catch-up contributions made under the House bill are not subject to any other contribution limits and are not taken into account in applying other contribution limits. Such contributions are subject to applicable nondiscrimination rules. Although catch-up contributions are subject to applicable nondiscrimination rules, a plan does not fail to meet the applicable nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features if the plan allows all eligible individuals participating in the plan to make the same election with respect to catch-up contributions. For purposes of this rule, all plans of related employers are treated as a single plan.

An employer is permitted to make matching contributions with respect to catch-up contributions. Any such matching contributions are subject to the normally applicable rules.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan is increased for individuals who have attained age 50 by the end of the year.[89] Additional contributions could be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the Senate amendment, the additional amount of elective contributions that could be made by an eligible individual participating in such a plan is the lesser of (1) the applicable dollar amount or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.[90] The applicable dollar amount is $500 for 2002 through 2004, $1,000 for 2005 and 2006, $2,000 for 2007, $3,000 for 2008, $4,000 for 2009, and $7,500 for 2010 and thereafter.

Catch-up contributions made under the Senate amendment are not subject to any other contribution limits and are not taken into

[88] In the case of a section 457 plans, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

[89] Another provision of the Senate amendment increases the dollar limit on elective deferrals under such arrangements.

[90] In the case of a section 457 plan, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

account in applying other contribution limits. In addition, such contributions are not subject to applicable nondiscrimination rules.[91]

An employer is permitted to make matching contributions with respect to catch-up contributions. Any such matching contributions are subject to the normally applicable rules.

The following examples illustrate the application of the Senate amendment, after the catch-up is fully phased-in.

Example 1: Employee A is a highly compensated employee who is over 50 and who participates in a section 401(k) plan sponsored by A's employer. The maximum annual deferral limit (without regard to the provision) is $15,000. After application of the special nondiscrimination rules applicable to section 401(k) plans, the maximum elective deferral A may make for the year is $8,000. Under the provision, A is able to make additional catch-up salary reduction contributions of $7,500.

Example 2: Employee B, who is over 50, is a participant in a section 401(k) plan. B's compensation for the year is $30,000. The maximum annual deferral limit (without regard to the provision) is $15,000. Under the terms of the plan, the maximum permitted deferral is 10 percent of compensation or, in B's case, $3,000. Under the provision, B can contribute up to $10,500 for the year ($3,000 under the normal operation of the plan, and an additional $7,500 under the provision).

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement provides that the otherwise applicable dollar limit on elective deferrals under a section 401(k) plan, section 403(b) annuity, SEP, or SIMPLE, or deferrals under a section 457 plan is increased for individuals who have attained age 50 by the end of the year.[92] The catch-up contribution provision does not apply to after-tax employee contributions. Additional contributions may be made by an individual who has attained age 50 before the end of the plan year and with respect to whom no other elective deferrals may otherwise be made to the plan for the year because of the application of any limitation of the Code (e.g., the annual limit on elective deferrals) or of the plan. Under the conference agreement, the additional amount of elective contributions that may be made by an eligible individual participating in such a plan is the lesser of (1) the applicable dollar amount or (2) the participant's compensation for the year reduced by any other elective deferrals of the participant for the year.[93] The applicable dollar amount under a section 401(k) plan, section 403(b) annuity, SEP, or section 457 plan is $1,000 for 2002, $2,000 for 2003, $3,000 for 2004, $4,000 for 2005, and $5,000 for 2006 and thereafter. The applicable dollar amount under a SIMPLE is $500 for 2002, $1,000 for 2003, $1,500 for 2004, $2,000 for 2005, and $2,500 for 2006 and

[91] Another provision increases the dollar limit on elective deferrals under such arrangements.

[92] Another provision of the conference agreement increases the dollar limit on elective deferrals under such arrangements.

[93] In the case of a section 457 plan, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

thereafter. The $5,000 and $2,500 amounts are adjusted for inflation in $500 increments in 2007 and thereafter.[94]

Catch-up contributions made under the conference agreement are not subject to any other contribution limits and are not taken into account in applying other contribution limits. In addition, such contributions are not subject to applicable nondiscrimination rules. However, a plan fails to meet the applicable nondiscrimination requirements under section 401(a)(4) with respect to benefits, rights, and features unless the plan allows all eligible individuals participating in the plan to make the same election with respect to catch-up contributions. For purposes of this rule, all plans of related employers are treated as a single plan.

An employer is permitted to make matching contributions with respect to catch-up contributions. Any such matching contributions are subject to the normally applicable rules.

The following examples illustrate the application of the conference agreement, after the catch-up is fully phased-in.

Example 1: Employee A is a highly compensated employee who is over 50 and who participates in a section 401(k) plan sponsored by A's employer. The maximum annual deferral limit (without regard to the provision) is $15,000. After application of the special nondiscrimination rules applicable to section 401(k) plans, the maximum elective deferral A may make for the year is $8,000. Under the provision, A is able to make additional catch-up salary reduction contributions of $5,000.

Example 2: Employee B, who is over 50, is a participant in a section 401(k) plan. B's compensation for the year is $30,000. The maximum annual deferral limit (without regard to the provision) is $15,000. Under the terms of the plan, the maximum permitted deferral is 10 percent of compensation or, in B's case, $3,000. Under the provision, B can contribute up to $8,000 for the year ($3,000 under the normal operation of the plan, and an additional $5,000 under the provision).

Effective date.—The Senate amendment is effective for taxable years beginning after December 31, 2001.

(b) Equitable treatment for contributions of employees to defined contribution plans (sec. 302 of the House bill, sec. 632 of the Senate amendment, and secs. 403(b), 415, and 457 of the Code)

PRESENT LAW

Present law imposes limits on the contributions that may be made to tax-favored retirement plans.

Defined contribution plans

In the case of a tax-qualified defined contribution plan, the limit on annual additions that can be made to the plan on behalf of an employee is the lesser of $35,000 (for 2001) or 25 percent of the employee's compensation (sec. 415(c)). Annual additions include employer contributions, including contributions made at the elec-

[94] In the case of a section 457 plans, this catch-up rule does not apply during the participant's last three years before retirement (in those years, the regularly applicable dollar limit is doubled).

tion of the employee (i.e., employee elective deferrals), after-tax employee contributions, and any forfeitures allocated to the employee. For this purpose, compensation means taxable compensation of the employee, plus elective deferrals, and similar salary reduction contributions. A separate limit applies to benefits under a defined benefit plan.

For years before January 1, 2000, an overall limit applied if an employee was a participant in both a defined contribution plan and a defined benefit plan of the same employer.

Tax-sheltered annuities

In the case of a tax-sheltered annuity (a "section 403(b) annuity"), the annual contribution generally cannot exceed the lesser of the exclusion allowance or the section 415(c) defined contribution limit. The exclusion allowance for a year is equal to 20 percent of the employee's includible compensation, multiplied by the employee's years of service, minus excludable contributions for prior years under qualified plans, tax-sheltered annuities or section 457 plans of the employer.

In addition to this general rule, employees of nonprofit educational institutions, hospitals, home health service agencies, health and welfare service agencies, and churches may elect application of one of several special rules that increase the amount of the otherwise permitted contributions. The election of a special rule is irrevocable; an employee may not elect to have more than one special rule apply.

Under one special rule, in the year the employee separates from service, the employee may elect to contribute up to the exclusion allowance, without regard to the 25 percent of compensation limit under section 415. Under this rule, the exclusion allowance is determined by taking into account no more than 10 years of service.

Under a second special rule, the employee may contribute up to the lesser of: (1) the exclusion allowance; (2) 25 percent of the participant's includible compensation; or (3) $15,000.

Under a third special rule, the employee may elect to contribute up to the section 415(c) limit, without regard to the exclusion allowance. If this option is elected, then contributions to other plans of the employer are also taken into account in applying the limit.

For purposes of determining the contribution limits applicable to section 403(b) annuities, includible compensation means the amount of compensation received from the employer for the most recent period which may be counted as a year of service under the exclusion allowance. In addition, includible compensation includes elective deferrals and similar salary reduction amounts.

Treasury regulations include provisions regarding application of the exclusion allowance in cases where the employee participates in a section 403(b) annuity and a defined benefit plan. The Taxpayer Relief Act of 1997 directed the Secretary of the Treasury to revise these regulations, effective for years beginning after December 31, 1999, to reflect the repeal of the overall limit on contributions and benefits.

Section 457 plans

Compensation deferred under an eligible deferred compensation plan of a tax-exempt or State and local governmental employer (a "section 457 plan") is not includible in gross income until paid or made available. In general, the maximum permitted annual deferral under such a plan is the lesser of (1) $8,500 (in 2001) or (2) 33⅓ percent of compensation. The $8,500 limit is increased for inflation in $500 increments.

HOUSE BILL

Increase in defined contribution plan limit

The House bill increases the 25 percent of compensation limitation on annual additions under a defined contribution plan[95] to 100 percent.[96]

Conforming limits on tax-sheltered annuities

The House bill repeals the exclusion allowance applicable to contributions to tax-sheltered annuities. Thus, such annuities are subject to the limits applicable to tax-qualified plans.

The House bill also directs the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance. For taxable years beginning after December 31, 1999, the regulatory provisions regarding the exclusion allowance are to be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void.

Section 457 plans

The House bill increases the 33⅓ percent of compensation limitation on deferrals under a section 457 plan to 100 percent of compensation.

Effective date.—The House bill generally is effective for years beginning after December 31, 2001. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modifications.

The Senate amendment increases the 25 percent of compensation limitation on annual additions under a defined contribution plan to 50 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.[97] The Senate amendment increases the 33⅓ percent of compensation limitation on deferrals under a section 457

[95] Another provision of the House bill increases the defined contribution plan dollar limit.

[96] The House bill preserves the present-law deduction rules for money purchase pension plans. Thus, for purposes of such rules, the limitation on the amount the employer generally may deduct is an amount equal to 25 percent of compensation of the employees covered by the plan for the year.

[97] Another provision of the Senate amendment increases the defined contribution plan dollar limit.

plan to 50 percent for 2002 through 2010, and 100 percent for 2011 and thereafter.

With respect to the direction to the Secretary of the Treasury to revise the regulations relating to the exclusion allowance under section 403(b)(2) to render void the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance, the regulatory provisions regarding the exclusion allowance are to be applied as if the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance were void for taxable years beginning after December 31, 2000.

Effective date.—The Senate amendment generally is effective for years beginning after December 31, 2001. The provision regarding the regulations under section 403(b)(2) is effective on the date of enactment. The provision regarding the repeal of the exclusion allowance applicable to tax-sheltered annuities is effective for years beginning after December 31, 2010.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications.

With respect to the increase in the defined contribution plan limit, the conferees intend that the Secretary of the Treasury will use the Secretary's existing authority to address situations where qualified nonelective contributions are targeted to certain participants with lower compensation in order to increase the average deferral percentage of nonhighly compensated employees.

For taxable years beginning after December 31, 1999, a plan may disregard the requirement that contributions to a defined benefit plan be treated as previously excluded amounts for purposes of the exclusion allowance.

(c) Faster vesting of employer matching contributions (sec. 303 of the House bill, sec. 633 of the Senate amendment, and sec. 411 of the Code)

PRESENT LAW

Under present law, a plan is not a qualified plan unless a participant's employer-provided benefit vests at least as rapidly as under one of two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of the participant's accrued benefit derived from employer contributions upon the completion of five years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to at least 20 percent of the participant's accrued benefit derived from employer contributions after three years of service, 40 percent after four years of service, 60 percent after five years of service, 80 percent after six years of service, and 100 percent after seven years of service.[98]

[98] The minimum vesting requirements are also contained in Title I of ERISA.

HOUSE BILL

The House bill applies faster vesting schedules to employer matching contributions. Under the House bill, employer matching contributions are required to vest at least as rapidly as under one of the following two alternative minimum vesting schedules. A plan satisfies the first schedule if a participant acquires a nonforfeitable right to 100 percent of employer matching contributions upon the completion of three years of service. A plan satisfies the second schedule if a participant has a nonforfeitable right to 20 percent of employer matching contributions for each year of service beginning with the participant's second year of service and ending with 100 percent after six years of service.

Effective date.—The House bill is effective for contributions for plan years beginning after December 31, 2001, with a delayed effective date for plans maintained pursuant to a collective bargaining agreement. The House bill does not apply to any employee until the employee has an hour of service after the effective date. In applying the new vesting schedule, service before the effective date is taken into account.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(d) Modifications to minimum distribution rules (sec. 304 of the House bill, sec. 634 of the Senate amendment, and sec. 401(a)(9) of the Code)

PRESENT LAW

In general

Minimum distribution rules apply to all types of tax-favored retirement vehicles, including qualified plans, individual retirement arrangements ("IRAs"), tax-sheltered annuities ("section 403(b) annuities"), and eligible deferred compensation plans of tax-exempt and State and local government employers ("section 457 plans"). In general, under these rules, distribution of minimum benefits must begin no later than the required beginning date. Minimum distribution rules also apply to benefits payable with respect to a plan participant who has died. Failure to comply with the minimum distribution rules results in an excise tax imposed on the individual plan participant equal to 50 percent of the required minimum distribution not distributed for the year. The excise tax may be waived if the individual establishes to the satisfaction of the Commissioner that the shortfall in the amount distributed was due to reasonable error and reasonable steps are being taken to remedy the shortfall. Under certain circumstances following the death of a participant, the excise tax is automatically waived under proposed Treasury regulations.

Distributions prior to the death of the individual

In the case of distributions prior to the death of the plan participant, the minimum distribution rules are satisfied if either (1) the participant's entire interest in the plan is distributed by the required beginning date, or (2) the participant's interest in the plan is to be distributed (in accordance with regulations), beginning not later than the required beginning date, over a permissible period. The permissible periods are (1) the life of the participant, (2) the lives of the participant and a designated beneficiary, (3) the life expectancy of the participant, or (4) the joint life and last survivor expectancy of the participant and a designated beneficiary. In calculating minimum required distributions, life expectancies of the participant and the participant's spouse may be recomputed annually.

In the case of qualified plans, tax-sheltered annuities, and section 457 plans, the required beginning date is the April 1 of the calendar year following the later of (1) the calendar year in which the employee attains age 70½ or (2) the calendar year in which the employee retires. However, in the case of a five-percent owner of the employer, distributions are required to begin no later than the April 1 of the calendar year following the year in which the five-percent owner attains age 70½. If commencement of benefits is delayed beyond age 70½ from a defined benefit plan, then the accrued benefit of the employee must be actuarially increased to take into account the period after age 70½ in which the employee was not receiving benefits under the plan.[99] In the case of distributions from an IRA other than a Roth IRA, the required beginning date is the April 1 of the calendar year following the calendar year in which the IRA owner attains age 70½. The pre-death minimum distribution rules do not apply to Roth IRAs.

In general, under the proposed Treasury regulations, in order to satisfy the minimum distribution rules, annuity payments under a defined benefit plan must be paid in periodic payments made at intervals not longer than one year over a permissible period, and must be nonincreasing, or increase only as a result of the following: (1) cost-of-living adjustments; (2) cash refunds of employee contributions; (3) benefit increases under the plan; or (4) an adjustment due to death of the employee's beneficiary. In the case of a defined contribution plan, the minimum required distribution is determined by dividing the employee's benefit by an amount from the uniform table provided in the proposed regulations.

Distributions after the death of the plan participant

The minimum distribution rules also apply to distributions to beneficiaries of deceased participants. In general, if the participant dies after minimum distributions have begun, the remaining interest must be distributed at least as rapidly as under the minimum distribution method being used as of the date of death. If the participant dies before minimum distributions have begun, then the entire remaining interest must generally be distributed within five years of the participant's death. The five-year rule does not apply

[99] State and local government plans and church plans are not required to actuarially increase benefits that begin after age 70½.

if distributions begin within one year of the participant's death and are payable over the life of a designated beneficiary or over the life expectancy of a designated beneficiary. A surviving spouse beneficiary is not required to begin distribution until the date the deceased participant would have attained age 70½.

HOUSE BILL

Modification of post-death distribution rules

The House bill applies the present-law rules applicable if the participant dies before distribution of minimum benefits has begun to all post-death distributions. Thus, in general, if the employee dies before his or her entire interest has been distributed, distribution of the remaining interest is required to be made within five years of the date of death, or begin within one year of the date of death and paid over the life or life expectancy of a designated beneficiary. In the case of a surviving spouse, distributions are not required to begin until April 1 of the calendar year following the calendar year in which the surviving spouse attains age 70½. The House bill includes a transition rule with respect to the provision providing that the required beginning date in the case of a surviving spouse is no earlier than the April 1 of the calendar year following the calendar year in which the surviving spouse attains age 70½. In the case of an individual who died before the date of enactment and prior to his or her required beginning date and whose beneficiary is the surviving spouse, minimum distributions to the surviving spouse are not required to begin earlier than the date distributions would have been required to begin under present law.

Reduction in excise tax

The House bill reduces the excise tax on failures to satisfy the minimum distribution rules to 10 percent of the amount that was required to be distributed but was not distributed.

Treasury regulations

The Treasury is directed to revise the life expectancy tables under the applicable regulations to reflect current life expectancy.

Effective date.—In general, the House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not modify the excise tax on failures to satisfy the minimum distribution rules.

CONFERENCE AGREEMENT

The conference agreement directs the Treasury to revise the life expectancy tables under the applicable regulations to reflect current life expectancy.

Effective date.—The conference agreement is effective on the date of enactment.

(e) Clarification of tax treatment of division of section 457 plan benefits upon divorce (sec. 305 of the House bill, sec. 635 of the Senate amendment, and secs. 414(p) and 457 of the Code)

PRESENT LAW

Under present law, benefits provided under a qualified retirement plan for a participant may not be assigned or alienated to creditors of the participant, except in very limited circumstances. One exception to the prohibition on assignment or alienation rule is a qualified domestic relations order ("QDRO"). A QDRO is a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant, and that meets certain procedural requirements.

Under present law, a distribution from a governmental plan or a church plan is treated as made pursuant to a QDRO if it is made pursuant to a domestic relations order that creates or recognizes a right of an alternate payee to any plan benefit payable with respect to a participant. Such distributions are not required to meet the procedural requirements that apply with respect to distributions from qualified plans.

Under present law, amounts distributed from a qualified plan generally are taxable to the participant in the year of distribution. However, if amounts are distributed to the spouse (or former spouse) of the participant by reason of a QDRO, the benefits are taxable to the spouse (or former spouse). Amounts distributed pursuant to a QDRO to an alternate payee other than the spouse (or former spouse) are taxable to the plan participant.

Section 457 of the Internal Revenue Code provides rules for deferral of compensation by an individual participating in an eligible deferred compensation plan ("section 457 plan") of a tax-exempt or State and local government employer. The QDRO rules do not apply to section 457 plans.

HOUSE BILL

The House bill applies the taxation rules for qualified plan distributions pursuant to a QDRO to distributions made pursuant to a domestic relations order from a section 457 plan. In addition, a section 457 plan does not violate the restrictions on distributions from such plans due to payments to an alternate payee under a QDRO. The special rule applicable to governmental plans and church plans applies for purposes of determining whether a distribution is pursuant to a QDRO.

Effective date.—The House bill is effective for transfers, distributions, and payments made after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with a modification of the effective date.

Effective date.—The provision of the Senate amendment relating to tax treatment of distributions made pursuant to a domestic relations order from a section 457 plan is effective for transfers, distributions, and payments made after December 31, 2001. The

provisions of the Senate amendment relating to the waiver of restrictions on distributions and the application of the special rule for determining whether a distribution is pursuant to a QDRO are effective on January 1, 2002, except that in the case of a domestic relations order entered before January 1, 2002, the plan administrator (1) is required to treat such order as a QDRO if the administrator is paying benefits pursuant to such order on January 1, 2002, and (2) is permitted to treat any other such order entered before January 1, 2002, as a QDRO even if such order does not meet the relevant requirements of the provision.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

(f) Provisions relating to hardship withdrawals (sec. 306 of the House bill, sec. 636 of the Senate amendment, and sec. 401(k) and 402 of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement (a "section 401(k) plan") may not be distributable prior to the occurrence of one or more specified events. One event upon which distribution is permitted is the financial hardship of the employee. Applicable Treasury regulations[100] provide that a distribution is made on account of hardship only if the distribution is made on account of an immediate and heavy financial need of the employee and is necessary to satisfy the heavy need.

The Treasury regulations provide a safe harbor under which a distribution may be deemed necessary to satisfy an immediate and heavy financial need. One requirement of this safe harbor is that the employee be prohibited from making elective contributions and employee contributions to the plan and all other plans maintained by the employer for at least 12 months after receipt of the hardship distribution.

Under present law, hardship withdrawals of elective deferrals from a qualified cash or deferred arrangement (or 403(b) annuity) are not eligible rollover distributions. Other types of hardship distributions, e.g., employer matching contributions distributed on account of hardship, are eligible rollover distributions. Different withholding rules apply to distributions that are eligible rollover distributions and to distributions that are not eligible rollover distributions. Eligible rollover distributions that are not directly rolled over are subject to withholding at a flat rate of 20-percent. Distributions that are not eligible rollover distributions are subject to elective withholding. Periodic distributions are subject to withholding as if the distribution were wages; nonperiodic distributions are subject to withholding at a rate of 10 percent. In either case, the individual may elect not to have withholding apply.

HOUSE BILL

The Secretary of the Treasury is directed to revise the applicable regulations to reduce from 12 months to six months the period

[100] Treas. Reg. sec. 1.401(k)–1.

during which an employee must be prohibited from making elective contributions and employee contributions in order for a distribution to be deemed necessary to satisfy an immediate and heavy financial need. The revised regulations are to be effective for years beginning after December 31, 2001.

In addition, any distribution made upon hardship of an employee is not an eligible rollover distribution. Thus, such distributions may not be rolled over, and are subject to the withholding rules applicable to distributions that are not eligible rollover distributions. The House bill does not modify the rules under which hardship distributions may be made. For example, as under present law, hardship distributions of qualified employer matching contributions are only permitted under the rules applicable to elective deferrals.

The House bill is intended to clarify that all assets distributed as a hardship withdrawal, including assets attributable to employee elective deferrals and those attributable to employer matching or nonelective contributions, are ineligible for rollover. This rule is intended to apply to all hardship distributions from any tax qualified plan, including those made pursuant to standards set forth in section 401(k)(2)(B)(i)(IV) (which are applicable to section 401(k) plans and section 403(b) annuities) and to those treated as hardship distributions under any profit-sharing plan (whether or not in accordance with the standards set forth in section 401(k)(2)(B)(i)(IV)). For this purpose, a distribution that could be made either under the hardship provisions of a plan or under other provisions of the plan (such as provisions permitting in-service withdrawal of assets attributable to employer matching or nonelective contributions after a fixed period of years) could be treated as made upon hardship of the employee if the plan treats it that way. For example, if a plan makes an in-service distribution that consists of assets attributable to both elective deferrals (in circumstances where those assets could be distributed only upon hardship) and employer matching or nonelective contributions (which could be distributed in nonhardship circumstances under the plan), the plan is permitted to treat the distribution in its entirety as made upon hardship of the employee.

Effective date.—The provision of the House bill directing the Secretary to revise the rules relating to safe harbor hardship distributions is effective on the date of enactment. The provision that hardship distributions are not eligible rollover distributions is effective for distributions made after December 31, 2001. The Secretary has the authority to issue transitional guidance with respect to the provision that hardship distributions are not eligible rollover distributions to provide sufficient time for plans to implement the new rule.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(g) Pension coverage for domestic and similar workers (sec. 307 of the House bill, sec. 637 of the Senate amendment, and sec. 4972(c)(6) of the Code)

PRESENT LAW

Under present law, within limits, employers may make deductible contributions to qualified retirement plans for employees. Subject to certain exceptions, a 10-percent excise tax applies to nondeductible contributions to such plans.

Employers of household workers may establish a pension plan for their employees. Contributions to such plans are not deductible because they are not made in connection with a trade or business of the employer.

HOUSE BILL

The 10-percent excise tax on nondeductible contributions does not apply to contributions to a SIMPLE plan or a SIMPLE IRA that are nondeductible solely because the contributions are not a trade or business expense under section 162 because they are not made in connection with a trade or business of the employer. Thus, for example, employers of household workers are able to make contributions to such plans without imposition of the excise tax. As under present law, the contributions are not deductible. The present-law rules applicable to such plans, e.g., contribution limits and nondiscrimination rules, continue to apply. The House bill does not apply with respect to contributions on behalf of the individual and members of his or her family.

No inference is intended with respect to the application of the excise tax under present law to contributions that are not deductible because they are not made in connection with a trade or business of the employer.

As under present law, a plan covering domestic workers is not qualified unless the coverage rules are satisfied by aggregating all employees of family members taken into account under the attribution rules in section 414(c), but disregarding employees employed by a controlled group of corporations or a trade or business.

It is intended that the House bill is restricted to contributions made by employers of household workers with respect to whom all applicable employment taxes have been and are being paid.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The legislative history of the Senate amendment does not include a statement of intention that the Senate amendment is restricted to contributions made by employers of household workers with respect to whom all applicable employment taxes have been and are being paid.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

3. Increasing Portability for Participants

(a) Rollovers of retirement plan and IRA distributions (secs. 401–403 and 409 of the House bill, secs. 641–643 and 649 of the Senate amendment, and secs. 401, 402, 403(b), 408, 457, and 3405 of the Code)

PRESENT LAW

In general

Present law permits the rollover of funds from a tax-favored retirement plan to another tax-favored retirement plan. The rules that apply depend on the type of plan involved. Similarly, the rules regarding the tax treatment of amounts that are not rolled over depend on the type of plan involved.

Distributions from qualified plans

Under present law, an "eligible rollover distribution" from a tax-qualified employer-sponsored retirement plan may be rolled over tax free to a traditional individual retirement arrangement ("IRA")[101] or another qualified plan.[102] An "eligible rollover distribution" means any distribution to an employee of all or any portion of the balance to the credit of the employee in a qualified plan, except the term does not include (1) any distribution which is one of a series of substantially equal periodic payments made (a) for the life (or life expectancy) of the employee or the joint lives (or joint life expectancies) of the employee and the employee's designated beneficiary, or (b) for a specified period of 10 years or more, (2) any distribution to the extent such distribution is required under the minimum distribution rules, and (3) certain hardship distributions. The maximum amount that can be rolled over is the amount of the distribution includible in income, i.e., after-tax employee contributions cannot be rolled over. Qualified plans are not required to accept rollovers.

Distributions from tax-sheltered annuities

Eligible rollover distributions from a tax-sheltered annuity ("section 403(b) annuity") may be rolled over into an IRA or another section 403(b) annuity. Distributions from a section 403(b) annuity cannot be rolled over into a tax-qualified plan. Section 403(b) annuities are not required to accept rollovers.

IRA distributions

Distributions from a traditional IRA, other than minimum required distributions, can be rolled over into another IRA. In general, distributions from an IRA cannot be rolled over into a qualified plan or section 403(b) annuity. An exception to this rule applies in the case of so-called "conduit IRAs." Under the conduit IRA rule, amounts can be rolled from a qualified plan into an IRA and then subsequently rolled back to another qualified plan if the

[101] A "traditional" IRA refers to IRAs other than Roth IRAs or SIMPLE IRAs. All references to IRAs refer only to traditional IRAs.

[102] An eligible rollover distribution may either be rolled over by the distributee within 60 days of the date of the distribution or, as described below, directly rolled over by the distributing plan.

amounts in the IRA are attributable solely to rollovers from a qualified plan. Similarly, an amount may be rolled over from a section 403(b) annuity to an IRA and subsequently rolled back into a section 403(b) annuity if the amounts in the IRA are attributable solely to rollovers from a section 403(b) annuity.

Distributions from section 457 plans

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. In some cases, different rules apply under section 457 to governmental plans and plans of tax-exempt employers. For example, governmental section 457 plans are like qualified plans in that plan assets are required to be held in a trust for the exclusive benefit of plan participants and beneficiaries. In contrast, benefits under a section 457 plan of a tax-exempt employer are unfunded, like nonqualified deferred compensation plans of private employers.

Section 457 benefits can be transferred to another section 457 plan. Distributions from a section 457 plan cannot be rolled over to another section 457 plan, a qualified plan, a section 403(b) annuity, or an IRA.

Rollovers by surviving spouses

A surviving spouse that receives an eligible rollover distribution may roll over the distribution into an IRA, but not a qualified plan or section 403(b) annuity.

Direct rollovers and withholding requirements

Qualified plans and section 403(b) annuities are required to provide that a plan participant has the right to elect that an eligible rollover distribution be directly rolled over to another eligible retirement plan. If the plan participant does not elect the direct rollover option, then withholding is required on the distribution at a 20-percent rate.[103]

Notice of eligible rollover distribution

The plan administrator of a qualified plan or a section 403(b) annuity is required to provide a written explanation of rollover rules to individuals who receive a distribution eligible for rollover. In general, the notice is to be provided within a reasonable period of time before making the distribution and is to include an explanation of (1) the provisions under which the individual may have the distribution directly rolled over to another eligible retirement plan, (2) the provision that requires withholding if the distribution is not directly rolled over, (3) the provision under which the distribution may be rolled over within 60 days of receipt, and (4) if applicable, certain other rules that may apply to the distribution. The Treasury Department has provided more specific guidance regarding timing and content of the notice.

[103] Distributions from qualified plans and section 403(b) annuities that are not eligible rollover distributions are subject to elective withholding. Periodic distributions are subject to withholding as if the distribution were wages; nonperiodic distributions are subject to withholding at a rate of 10 percent. In either case, the individual may elect not to have withholding apply.

Taxation of distributions

As is the case with the rollover rules, different rules regarding taxation of benefits apply to different types of tax-favored arrangements. In general, distributions from a qualified plan, section 403(b) annuity, or IRA are includible in income in the year received. In certain cases, distributions from qualified plans are eligible for capital gains treatment and averaging. These rules do not apply to distributions from another type of plan. Distributions from a qualified plan, IRA, and section 403(b) annuity generally are subject to an additional 10-percent early withdrawal tax if made before age 59½. There are a number of exceptions to the early withdrawal tax. Some of the exceptions apply to all three types of plans, and others apply only to certain types of plans. For example, the 10-percent early withdrawal tax does not apply to IRA distributions for educational expenses, but does apply to similar distributions from qualified plans and section 403(b) annuities. Benefits under a section 457 plan are generally includible in income when paid or made available. The 10-percent early withdrawal tax does not apply to section 457 plans.

HOUSE BILL

In general

The House bill provides that eligible rollover distributions from qualified retirement plans, section 403(b) annuities, and governmental section 457 plans generally could be rolled over to any of such plans or arrangements.[104] Similarly, distributions from an IRA generally are permitted to be rolled over into a qualified plan, section 403(b) annuity, or governmental section 457 plan. The direct rollover and withholding rules are extended to distributions from a governmental section 457 plan, and such plans are required to provide the written notification regarding eligible rollover distributions.[105] The rollover notice (with respect to all plans) is required to include a description of the provisions under which distributions from the plan to which the distribution is rolled over may be subject to restrictions and tax consequences different than those applicable to distributions from the distributing plan. Qualified plans, section 403(b) annuities, and section 457 plans would not be required to accept rollovers.

Some special rules apply in certain cases. A distribution from a qualified plan is not eligible for capital gains or averaging treatment if there was a rollover to the plan that would not have been permitted under present law. Thus, in order to preserve capital gains and averaging treatment for a qualified plan distribution that is rolled over, the rollover would have to be made to a "conduit IRA" as under present law, and then rolled back into a qualified plan. Amounts distributed from a section 457 plan are subject to

[104] Hardship distributions from governmental section 457 plans would be considered eligible rollover distributions.

[105] The elective withholding rules applicable to distributions from qualified plans and section 403(b) annuities that are not eligible rollover distributions are also extended to distributions from governmental section 457 plans. Thus, periodic distributions from governmental section 457 plans that are not eligible rollover distributions are subject to withholding as if the distribution were wages and nonperiodic distributions from such plans that are not eligible rollover distributions are subject to withholding at a 10-percent rate. In either case, the individual may elect not to have withholding apply.

the early withdrawal tax to the extent the distribution consists of amounts attributable to rollovers from another type of plan. Section 457 plans are required to separately account for such amounts.

Rollover of after-tax contributions

The House bill provides that employee after-tax contributions may be rolled over into another qualified plan or a traditional IRA. In the case of a rollover from a qualified plan to another qualified plan, the rollover is permitted to be accomplished only through a direct rollover. In addition, a qualified plan is not permitted to accept rollovers of after-tax contributions unless the plan provides separate accounting for such contributions (and earnings thereon). After-tax contributions (including nondeductible contributions to an IRA) are not permitted to be rolled over from an IRA into a qualified plan, tax-sheltered annuity, or section 457 plan.

In the case of a distribution from a traditional IRA that is rolled over into an eligible rollover plan that is not an IRA, the distribution is attributed first to amounts other than after-tax contributions.

Expansion of spousal rollovers

The House bill provides that surviving spouses may roll over distributions to a qualified plan, section 403(b) annuity, or governmental section 457 plan in which the surviving spouse participates.

Treasury regulations

The Secretary is directed to prescribe rules necessary to carry out the House bill. Such rules may include, for example, reporting requirements and mechanisms to address mistakes relating to rollovers. It is anticipated that the IRS will develop forms to assist individuals who roll over after-tax contributions to an IRA in keeping track of such contributions. Such forms could, for example, expand Form 8606—Nondeductible IRAs, to include information regarding after-tax contributions.

Effective date.—The House bill is effective for distributions made after December 31, 2001. It is intended that the Secretary will revise the safe harbor rollover notice that plans may use to satisfy the rollover requirements. No penalty is imposed on a plan for a failure to provide the information required under the House bill with respect to any distribution made before the date that is 90 days after the date the Secretary issues a new safe harbor rollover notice, if the plan administrator makes a reasonable attempt to comply with such notice requirement. For example, the House bill requires that the rollover notice include a description of the provisions under which distributions from the eligible retirement plan receiving the distribution may be subject to restrictions and tax consequences which are different from those applicable to distributions from the plan making the distribution. A plan is treated as making a reasonable good faith effort to comply with this requirement if the notice states that distributions from the plan to which the rollover is made may be subject to different restrictions and tax consequences than those that apply to distributions from the plan from which the rollover is made.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not include a provision for relief from the imposition of a penalty for failure to provide the information required under the Senate amendment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modification. Hardship distributions from governmental section 457 plans are not considered eligible rollover distributions.

(b) Waiver of 60-day rule (sec. 404 of the House bill, sec. 644 of the Senate amendment, and secs. 402 and 408 of the Code)

PRESENT LAW

Under present law, amounts received from an IRA or qualified plan may be rolled over tax free if the rollover is made within 60 days of the date of the distribution. The Secretary does not have the authority to waive the 60-day requirement, except during military service in a combat zone or by reason of a Presidentially declared disaster. The Secretary has issued regulations postponing the 60-day rule in such cases.

HOUSE BILL

The House bill provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. For example, the Secretary may issue guidance that includes objective standards for a waiver of the 60-day rollover period, such as waiving the rule due to military service in a combat zone or during a Presidentially declared disaster (both of which are provided for under present law), or for a period during which the participant has received payment in the form of a check, but has not cashed the check, or for errors committed by a financial institution.

Effective date.—The House bill applies to distributions made after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement provides that the Secretary may waive the 60-day rollover period if the failure to waive such requirement would be against equity or good conscience, including cases of casualty, disaster, or other events beyond the reasonable control of the individual subject to such requirement. For example, the Secretary may issue guidance that includes objective standards for a waiver of the 60-day rollover period, such as waiving the rule due to military service in a combat zone or during a Presidentially declared disaster (both of which are provided for under present

law), or for a period during which the participant has received payment in the form of a check, but has not cashed the check, or for errors committed by a financial institution, or in cases of inability to complete a rollover due to death, disability, hospitalization, incarceration, restrictions imposed by a foreign country, or postal error.

Effective date.—The conference agreement applies to distributions made after December 31, 2001.

(c) Treatment of forms of distribution (sec. 405 of the House bill, sec. 645 of the Senate amendment, and sec. 411(d)(6) of the Code)

PRESENT LAW

An amendment of a qualified retirement plan may not decrease the accrued benefit of a plan participant. An amendment is treated as reducing an accrued benefit if, with respect to benefits accrued before the amendment is adopted, the amendment has the effect of either (1) eliminating or reducing an early retirement benefit or a retirement-type subsidy, or (2) except as provided by Treasury regulations, eliminating an optional form of benefit (sec. 411(d)(6)).[106]

Under regulations recently issued by the Secretary,[107] this prohibition against the elimination of an optional form of benefit does not apply in the case of (1) a defined contribution plan that offers a lump sum at the same time as the form being eliminated if the participant receives at least 90 days' advance notice of the elimination, or (2) a voluntary transfer between defined contribution plans, subject to the requirements that a transfer from a money purchase pension plan, an ESOP, or a section 401(k) plan must be to a plan of the same type and that the transfer be made in connection with certain corporate mergers, acquisitions, or similar transactions or changes in employment status.

HOUSE BILL

A defined contribution plan to which benefits are transferred will not be treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, and (4) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution. The House bill does not modify

[106] A similar provision is contained in Title I of ERISA.
[107] Treas. Reg. sec. 1.411(d)–4, Q&A–2(e) and Q&A–(3)(b).

the rules relating to survivor annuities under section 417. Thus, as under present law, a plan that is a transferee of a plan subject to the joint and survivor rules is also subject to those rules.

Except to the extent provided by the Secretary of the Treasury in regulations, a defined contribution plan is not treated as reducing a participant's accrued benefit if (1) a plan amendment eliminates a form of distribution previously available under the plan, (2) a single sum distribution is available to the participant at the same time or times as the form of distribution eliminated by the amendment, and (3) the single sum distribution is based on the same or greater portion of the participant's accrued benefit as the form of distribution eliminated by the amendment.

Furthermore, the House bill directs the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

It is intended that the factors to be considered in determining whether an amendment has more than a de minimis adverse effect on any participant will include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

This provision of the House bill does not affect the rules relating to involuntary cash outs (sec. 411(a)(11)) or survivor annuity requirements (sec. 417). Accordingly, if a participant is entitled to protections of the joint and survivor rules, those protections may not be eliminated. The intent of the provision authorizing regulations is solely to permit the elimination of early retirement benefits, retirement-type subsidies, or optional forms of benefit that have no more than a de minimis effect on any participant but create disproportionate burdens and complexities for a plan and its participants.

For example, assume the following. Employer A acquires employer B and merges B's defined benefit plan into A's defined benefit plan. The defined benefit plan maintained by B before the merger provides an early retirement subsidy for individuals age 55 with a specified number of years of service. E1 and E2 are were employees of B and who transfer to A in connection with the merger. E1 is 25 years old and has compensation of $40,000. The present value of E1's early retirement subsidy under B's plan is

$75. E2 is 50 years old and also has compensation of $40,000. The present value of E2's early retirement subsidy under B's plan is $10,000.

Assume that A's plan has an early retirement subsidy for individuals who have attained age 50 with a specified number of years of service, but the subsidy is not the same as under B's plan. Under A's plan, the present value of E2's early retirement subsidy is $9,850. Maintenance of both subsidies after the plan merger would create burdens for the plan and complexities for the plan and its participants.

Treasury regulations could permit E1's early retirement subsidy under B's plan to be eliminated entirely (i.e., even if A's plan did not have an early retirement subsidy). Taking into account all relevant factors, including the value of the benefit, E1's compensation, and the number of years until E1 would be eligible to receive the subsidy, the subsidy is de minimis. Treasury regulations could permit E2's early retirement subsidy under B's plan to be eliminated as to be replaced by the subsidy under A's plan, because the difference in the subsidies is de minimis. However, A's subsidy could not be entirely eliminated.

The Secretary is directed to issue, not later than December 31, 2003, final regulations under section 411(d)(6), including regulations required under the House bill.

Effective date.—The House bill is effective for years beginning after December 31, 2001, except that the direction to the Secretary is effective on the date of enactment.

SENATE AMENDMENT

A defined contribution plan to which benefits are transferred is not treated as reducing a participant's or beneficiary's accrued benefit even though it does not provide all of the forms of distribution previously available under the transferor plan if (1) the plan receives from another defined contribution plan a direct transfer of the participant's or beneficiary's benefit accrued under the transferor plan, or the plan results from a merger or other transaction that has the effect of a direct transfer (including consolidations of benefits attributable to different employers within a multiple employer plan), (2) the terms of both the transferor plan and the transferee plan authorize the transfer, (3) the transfer occurs pursuant to a voluntary election by the participant or beneficiary that is made after the participant or beneficiary received a notice describing the consequences of making the election, and (4) the transferee plan allows the participant or beneficiary to receive distribution of his or her benefit under the transferee plan in the form of a single sum distribution.

Furthermore, the Senate amendment directs the Secretary of the Treasury to provide by regulations that the prohibitions against eliminating or reducing an early retirement benefit, a retirement-type subsidy, or an optional form of benefit do not apply to plan amendments that eliminate or reduce early retirement benefits, retirement-type subsidies, and optional forms of benefit that create significant burdens and complexities for a plan and its participants, but only if such an amendment does not adversely affect the rights of any participant in more than a de minimis manner.

It is intended that the factors to be considered in determining whether an amendment has more than a de minimis adverse effect on any participant will include (1) all of the participant's early retirement benefits, retirement-type subsidies, and optional forms of benefits that are reduced or eliminated by the amendment, (2) the extent to which early retirement benefits, retirement-type subsidies, and optional forms of benefit in effect with respect to a participant after the amendment effective date provide rights that are comparable to the rights that are reduced or eliminated by the plan amendment, (3) the number of years before the participant attains normal retirement age under the plan (or early retirement age, as applicable), (4) the size of the participant's benefit that is affected by the plan amendment, in relation to the amount of the participant's compensation, and (5) the number of years before the plan amendment is effective.

The Secretary is directed to issue, not later than December 31, 2002, final regulations under section 411(d)(6), including regulations required under the Senate amendment.

Effective date.—The provision is effective for years beginning after December 31, 2001, except that the direction to the Secretary is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

(d) Rationalization of restrictions on distributions (sec. 406 of the House bill, sec. 646 of the Senate amendment, and secs. 401(k), 403(b), and 457 of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan"), tax-sheltered annuity ("section 403(b) annuity"), or an eligible deferred compensation plan of a tax-exempt organization or State or local government ("section 457 plan"), may not be distributable prior to the occurrence of one or more specified events. These permissible distributable events include "separation from service."

A separation from service occurs only upon a participant's death, retirement, resignation or discharge, and not when the employee continues on the same job for a different employer as a result of the liquidation, merger, consolidation or other similar corporate transaction. A severance from employment occurs when a participant ceases to be employed by the employer that maintains the plan. Under a so-called "same desk rule," a participant's severance from employment does not necessarily result in a separation from service.[108]

In addition to separation from service and other events, a section 401(k) plan that is maintained by a corporation may permit distributions to certain employees who experience a severance from employment with the corporation that maintains the plan but do not experience a separation from service because the employees continue on the same job for a different employer as a result of a

[108] Rev. Rul. 79–336, 1979–2 C.B. 187.

corporate transaction. If the corporation disposes of substantially all of the assets used by the corporation in a trade or business, a distributable event occurs with respect to the accounts of the employees who continue employment with the corporation that acquires the assets. If the corporation disposes of its interest in a subsidiary, a distributable event occurs with respect to the accounts of the employees who continue employment with the subsidiary. Under a recent IRS ruling, a person is generally deemed to have separated from service if that person is transferred to another employer in connection with a sale of less than substantially all the assets of a trade or business.[109]

HOUSE BILL

The House bill modifies the distribution restrictions applicable to section 401(k) plans, section 403(b) annuities, and section 457 plans to provide that distribution may occur upon severance from employment rather than separation from service. In addition, the provisions for distribution from a section 401(k) plan based upon a corporation's disposition of its assets or a subsidiary are repealed; this special rule is no longer necessary under the House bill.

Effective date.—The House bill is effective for distributions after December 31, 2001, regardless of when the severance of employment occurred.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

The conferees intend that a plan may provide that certain specified types of severance from employment do not constitute distributable events. For example, a plan could provide that a severance from employment is not a distributable event if it would not have constituted a "separation from service" under the law in effect prior to a specified date. Also, if a plan describes distributable events by reference to section 401(k)(2), the plan may be amended to restrict distributable events to fewer than all events that constitute a severance from employment. Thus, for example, if a plan sponsor had employees who experienced a severance from employment in the past that the "same desk rule" prevented from being treated as a distributable event, the plan sponsor would have the option of providing in the plan that such severance from employment would, or would not, be treated as a distributable event under the plan.

The conferees intend that, as under current law, if there is a transfer of plan assets and liabilities relating to any portion of an employee's benefit under a plan of the employee's former employer to a plan being maintained or created by the employee's new employer (other than a rollover or elective transfer), then that employee has not experienced a severance from employment with the employer maintaining the plan that covers the employee.

[109] Rev. Rul. 2000–27, 2000–21 I.R.B. 1016.

(e) Purchase of service credit under governmental pension plans (sec. 407 of the House bill, sec. 647 of the Senate amendment, and secs. 403(b) and 457 of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government employer may provide that a participant may make after-tax employee contributions in order to purchase permissive service credit, subject to certain limits (sec. 415). Permissive service credit means credit for a period of service recognized by the governmental plan only if the employee voluntarily contributes to the plan an amount (as determined by the plan) that does not exceed the amount necessary to fund the benefit attributable to the period of service and that is in addition to the regular employee contributions, if any, under the plan.

In the case of any repayment of contributions and earnings to a governmental plan with respect to an amount previously refunded upon a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State), any such repayment is not taken into account for purposes of the section 415 limits on contributions and benefits. Also, service credit obtained as a result of such a repayment is not considered permissive service credit for purposes of the section 415 limits.

A participant may not use a rollover or direct transfer of benefits from a tax-sheltered annuity ("section 403(b) annuity") or an eligible deferred compensation plan of a tax-exempt organization or a State or local government ("section 457 plan") to purchase permissive service credits or repay contributions and earnings with respect to a forfeiture of service credit.

HOUSE BILL

A participant in a State or local governmental plan is not required to include in gross income a direct trustee-to-trustee transfer to a governmental defined benefit plan from a section 403(b) annuity or a section 457 plan if the transferred amount is used (1) to purchase permissive service credits under the plan, or (2) to repay contributions and earnings with respect to an amount previously refunded under a forfeiture of service credit under the plan (or another plan maintained by a State or local government employer within the same State).

Effective date.—The House bill is effective for transfers after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(f) Employers may disregard rollovers for purposes of cash-out rules (sec. 408 of the House bill, sec. 648 of the Senate amendment, and sec. 411(a)(11) of the Code)

PRESENT LAW

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.[110]

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan.[111]

HOUSE BILL

For purposes of the cash-out rule, a plan is permitted to provide that the present value of a participant's nonforfeitable accrued benefit is determined without regard to the portion of such benefit that is attributable to rollover contributions (and any earnings allocable thereto).

Effective date.—The House bill is effective for distributions after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(g) Minimum distribution and inclusion requirements for section 457 plans (sec. 409 of the House bill, sec. 649 of the Senate amendment, and sec. 457 of the Code)

PRESENT LAW

A "section 457 plan" is an eligible deferred compensation plan of a State or local government or tax-exempt employer that meets certain requirements. For example, amounts deferred under a section 457 plan cannot exceed certain limits. Amounts deferred under a section 457 plan are generally includible in income when paid or made available. Amounts deferred under a plan of deferred compensation of a State or local government or tax-exempt employer that does not meet the requirements of section 457 are includible in income when the amounts are not subject to a substantial risk

[110] A similar provision is contained in Title I of ERISA.
[111] Other provisions expand the kinds of plans to which benefits may be rolled over.

of forfeiture, regardless of whether the amounts have been paid or made available.[112]

Section 457 plans are subject to the minimum distribution rules applicable to tax-qualified pension plans. In addition, such plans are subject to additional minimum distribution rules (sec. 457(d)(2)(B)).

HOUSE BILL

The House bill provides that amounts deferred under a section 457 plan of a State or local government are includible in income when paid. The House bill also repeals the special minimum distribution rules applicable to section 457 plans. Thus, such plans are subject to the minimum distribution rules applicable to qualified plans.

Effective date.—The House bill is effective for distributions after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification.

The Senate amendment also modifies the transition rule adopted in the 1986 Act relating to deferred compensation plans of tax-exempt employers. Under the Senate amendment, the transition rule applies to agreements providing cost-of-living adjustments to amounts that otherwise satisfy the requirements of the transition rule. The grandfather does not apply to the extent that the annual amount provided under such an agreement exceeds the annual grandfathered amount multiplied by the cumulative increase in the Consumer Price Index (as published by the Department of Labor).

Effective date.—The Senate amendment is generally effective for distributions after December 31, 2001. The provision relating to plans of tax-exempt organizations is effective for taxable years ending after the date of enactment for cost-of-living increases after September 1993.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

4. Strengthening Pension Security and Enforcement

(a) Phase in repeal of 160 percent of current liability funding limit; deduction for contributions to fund termination liability (secs. 501–502 of the House bill, secs. 651–652 of the Senate amendment, and secs. 404(a)(1), 412(c)(7), and 4972(c) of the Code)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pen-

[112] This rule of inclusion does not apply to amounts deferred under a tax-qualified retirement plan or similar plans.

sion plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)).[113] In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[114] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

HOUSE BILL

Current liability full funding limit

The House bill gradually increases and then repeals the current liability full funding limit. Under the bill, the current liability full funding limit is 165 percent of current liability for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter. Thus, in 2004 and thereafter, the full funding limit is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the House bill applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.[115]

The House bill also modifies the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for the plan

[113] The minimum funding requirements, including the full funding limit, are also contained in title I of ERISA.

[114] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text.

[115] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

year, termination liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

General Accounting Office study

In connection with the Committee's desire to strengthen pension security, the Committee directs the General Accounting Office to conduct a study examining the extent to which certain present-law rules create obstacles or disincentives for taxpayers experiencing financial hardships to make current and future contributions to underfunded defined benefit pension plans. The Committee is concerned that, as a result of not obtaining a current or carryback deduction for pension contributions, taxpayers experiencing financial hardships will be subject to higher after-tax costs of maintaining pension funding levels. In the study, the General Accounting Office is to consider whether pension funding would be enhanced if section 172(f), which since 1998 has permitted only listed items to be carried back, were modified to list deductions for payments to defined benefit pension plans as an item for which 10-year specified loss carrybacks may be available. This study is to be submitted to the Committee on Ways and Means of the House of Representatives and the Committee on Finance of the Senate not later than one year after the date of enactment.

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

Current liability full funding limit

The Senate amendment gradually increases and then repeals the current liability full funding limit. Under the Senate amendment, the current liability full funding limit is 160 percent of current liability for plan years beginning in 2002, 165 percent for plan years beginning in 2003, and 170 percent for plan years beginning in 2004. The current liability full funding limit is repealed for plan years beginning in 2005 and thereafter. Thus, in 2005 and thereafter, the full funding limit is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

Deduction for contributions to fund termination liability

The special rule allowing a deduction for unfunded current liability generally is extended to all defined benefit pension plans, i.e., the Senate amendment applies to multiemployer plans and plans with 100 or fewer participants. The special rule does not apply to plans not covered by the PBGC termination insurance program.[116]

The Senate amendment also modifies the rule by providing that the deduction is for up to 100 percent of unfunded termination liability, determined as if the plan terminated at the end of the plan year. In the case of a plan with less than 100 participants for

[116] The PBGC termination insurance program does not cover plans of professional service employers that have fewer than 25 participants.

the plan year, termination liability does not include the liability attributable to benefit increases for highly compensated employees resulting from a plan amendment which was made or became effective, whichever is later, within the last two years.

Effective date.—The Senate amendment is effective for plan years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications.

The conference agreement gradually increases and then repeals the current liability full funding limit. Under the conference agreement, the current liability full funding limit is 165 percent of current liability for plan years beginning in 2002, and 170 percent for plan years beginning in 2003. The current liability full funding limit is repealed for plan years beginning in 2004 and thereafter. Thus, in 2004 and thereafter, the full funding limit is the excess, if any, of (1) the accrued liability under the plan (including normal cost), over (2) the value of the plan's assets.

With respect to the special rule allowing a deduction for unfunded current liability, the modification of the rule to provide that the deduction is for up to 100 percent of unfunded termination liability is applicable only for a plan that terminates within the plan year.

(b) Excise tax relief for sound pension funding (sec. 503 of the House bill, sec. 653 of the Senate amendment, and sec. 4972 of the Code)

PRESENT LAW

Under present law, defined benefit pension plans are subject to minimum funding requirements designed to ensure that pension plans have sufficient assets to pay benefits. A defined benefit pension plan is funded using one of a number of acceptable actuarial cost methods.

No contribution is required under the minimum funding rules in excess of the full funding limit. The full funding limit is generally defined as the excess, if any, of (1) the lesser of (a) the accrued liability under the plan (including normal cost) or (b) 160 percent of the plan's current liability, over (2) the value of the plan's assets (sec. 412(c)(7)). In general, current liability is all liabilities to plan participants and beneficiaries accrued to date, whereas the accrued liability full funding limit is based on projected benefits. The current liability full funding limit is scheduled to increase as follows: 165 percent for plan years beginning in 2003 and 2004, and 170 percent for plan years beginning in 2005 and thereafter.[117] In no event is a plan's full funding limit less than 90 percent of the plan's current liability over the value of the plan's assets.

[117] As originally enacted in the Pension Protection Act of 1997, the current liability full funding limit was 150 percent of current liability. The Taxpayer Relief Act of 1997 increased the current liability full funding limit to 155 percent in 1999 and 2000, 160 percent in 2001 and 2002, and adopted the scheduled increases described in the text. Another provision would gradually increase and then repeal the current liability full funding limit.

An employer sponsoring a defined benefit pension plan generally may deduct amounts contributed to satisfy the minimum funding standard for the plan year. Contributions in excess of the full funding limit generally are not deductible. Under a special rule, an employer that sponsors a defined benefit pension plan (other than a multiemployer plan) which has more than 100 participants for the plan year may deduct amounts contributed of up to 100 percent of the plan's unfunded current liability.

Present law also provides that contributions to defined contribution plans are deductible, subject to certain limitations.

Subject to certain exceptions, an employer that makes nondeductible contributions to a plan is subject to an excise tax equal to 10 percent of the amount of the nondeductible contributions for the year. The 10-percent excise tax does not apply to contributions to certain terminating defined benefit plans. The 10-percent excise tax also does not apply to contributions of up to six percent of compensation to a defined contribution plan for employer matching and employee elective deferrals.

HOUSE BILL

In determining the amount of nondeductible contributions, the employer is permitted to elect not to take into account contributions to a defined benefit pension plan except to the extent they exceed the accrued liability full funding limit. Thus, if an employer elects, contributions in excess of the current liability full funding limit are not subject to the excise tax on nondeductible contributions. An employer making such an election for a year is not permitted to take advantage of the present-law exceptions for certain terminating plans and certain contributions to defined contribution plans. The House bill applies to terminated plans as well as ongoing plans.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(c) Notice of significant reduction in plan benefit accruals (sec. 504 of the House bill, sec. 659 of the Senate amendment, and new sec. 4980f of the Code)

PRESENT LAW

Section 204(h) of Title I of ERISA provides that a defined benefit pension plan or a money purchase pension plan may not be amended so as to provide for a significant reduction in the rate of future benefit accrual, unless, after adoption of the plan amendment and not less than 15 days before the effective date of the plan amendment, the plan administrator provides a written notice ("section 204(h) notice"), setting forth the plan amendment (or a summary of the amendment written in a manner calculated to be un-

derstood by the average plan participant) and its effective date. The plan administrator must provide the section 204(h) notice to each plan participant, each alternate payee under an applicable qualified domestic relations order ("QDRO"), and each employee organization representing participants in the plan. The applicable Treasury regulations[118] provide, however, that a plan administrator need not provide the section 204(h) notice to any participant or alternate payee whose rate of future benefit accrual is reasonably expected not to be reduced by the amendment, nor to an employee organization that does not represent a participant to whom the section 204(h) notice must be provided. In addition, the regulations provide that the rate of future benefit accrual is determined without regard to optional forms of benefit, early retirement benefits, retirement-type subsidiaries, ancillary benefits, and certain other rights and features.

A covered amendment generally will not become effective with respect to any participants and alternate payees whose rate of future benefit accrual is reasonably expected to be reduced by the amendment but who do not receive a section 204(h) notice. An amendment will become effective with respect to all participants and alternate payees to whom the section 204(h) notice was required to be provided if the plan administrator (1) has made a good faith effort to comply with the section 204(h) notice requirements, (2) has provided a section 204(h) notice to each employee organization that represents any participant to whom a section 204(h) notice was required to be provided, (3) has failed to provide a section 204(h) notice to no more than a de minimis percentage of participants and alternate payees to whom a section 204(h) notice was required to be provided, and (4) promptly upon discovering the oversight, provides a section 204(h) notice to each omitted participant and alternate payee.

The Internal Revenue Code does not require any notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual.

HOUSE BILL

The House bill adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan or a money purchase pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy. The plan administrator is required to provide in this notice, in a manner calculated to be understood by the average plan participant, sufficient information (as defined in Treasury regulations) to allow participants to understand the effect of the amendment.

The notice requirement does not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)). The House bill authorizes the Secretary of the Treasury to provide a simplified notice requirement or an exemption from the notice requirement for plans with less than 100

[118] Treas. Reg. sec. 1.411(d)–6.

participants and to allow any notice required under the House bill to be provided by using new technologies. The House bill also authorizes the Secretary to provide a simplified notice requirement or an exemption from the notice requirement if participants are given the option to choose between benefits under the new plan formula and the old plan formula. In such cases, the House bill will have no effect on the fiduciary rules applicable to pension plans that may require appropriate disclosure to participants, even if no disclosure is required under the House bill.

The plan administrator is required to provide this notice to each affected participant, each affected alternate payee, and each employee organization representing affected participants. For purposes of the House bill, an affected participant or alternate payee is a participant or alternate payee whose rate of future benefit accrual may reasonably be expected to be significantly reduced by the plan amendment.

Except to the extent provided by Treasury regulations, the plan administrator is required to provide the notice within a reasonable time before the effective date of the plan amendment. The House bill permits a plan administrator to provide any notice required under the House bill to a person designated in writing by the individual to whom it would otherwise be provided.

The House bill imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. No excise tax is imposed during any period during which any person subject to liability for the tax did not know that the failure existed and exercised reasonable diligence to meet the notice requirement. In addition, no excise tax is imposed on any failure if any person subject to liability for the tax exercised reasonable diligence to meet the notice requirement and such person provides the required notice during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that the failure existed. Also, if the person subject to liability for the excise tax exercised reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax would be excessive relative to the failure involved.

It is intended under the House bill that the Secretary issue the necessary regulations with respect to disclosure within 90 days of enactment. It is also intended that such guidance may be relatively detailed because of the need to provide for alternative disclosures rather than a single disclosure methodology that may not fit all situations, and the need to consider the complex actuarial calculations and assumptions involved in providing necessary disclosures.

In addition, the House bill directs the Secretary of the Treasury to prepare a report on the effects of conversions of traditional defined benefit plans to cash balance or hybrid formula plans. Such study is to examine the effect of such conversions on longer service participants, including the incidence and effects of "wear away" provisions under which participants earn no additional benefits for

a period of time after the conversion. The Secretary is directed to submit such report, together with recommendations thereon, to the Committee on Ways and Means and the Committee on Education and the Workforce of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate as soon as practicable, but not later than 60 days after the date of enactment.

Effective date.—The House bill is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the House bill will not end before the last day of the three-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan is treated as meeting the requirements of the House bill if the plan makes a good faith effort to comply with such requirements. The notice requirement under the House bill does not apply to any plan amendment taking effect on or after the date of enactment if, before April 25, 2001, notice is provided to participants and beneficiaries adversely affected by the plan amendment (or their representatives) that is reasonably expected to notify them of the nature and effective date of the plan amendment.

SENATE AMENDMENT

The Senate amendment adds to the Internal Revenue Code a requirement that the plan administrator of a defined benefit pension plan furnish a written notice concerning a plan amendment that provides for a significant reduction in the rate of future benefit accrual, including any elimination or reduction of an early retirement benefit or retirement-type subsidy.[119] The notice is required to set forth: (1) a summary of the plan amendment and the effective date of the amendment; (2) a statement that the amendment is expected to significantly reduce the rate of future benefit accrual; (3) a description of the classes of employees reasonably expected to be affected by the reduction in the rate of future benefit accrual; (4) examples illustrating the plan changes for these classes of employees; (5) in the event of an amendment that results in the significant restructuring of the plan benefit formula, as determined under regulations prescribed by the Secretary (a "significant restructuring amendment"), a notice that the plan administrator will provide, generally no later than 15 days prior to the effective date of the amendment, a "benefit estimation tool kit" (described below) that will enable employees who have completed at least one year of participation to personalize the illustrative examples; and (6) notice of each affected participant's right to request, and of the procedures for requesting, an annual benefit statement as provided under present law. The plan administrator is required to provide the notice not less than 45 days before the effective date of the plan amendment.

[119] The provision also modifies the present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual in the event of a failure by the plan administrator to exercise due diligence in meeting a notice requirement similar to the notice requirement that the provision adds to the Internal Revenue Code. In addition, the provision expands the current ERISA notice requirement regarding significant reductions in normal retirement benefit accrual rates to early retirement benefits and retirement-type subsidies.

The notice requirement does not apply to governmental plans or church plans with respect to which an election to have the qualified plan participation, vesting, and funding rules apply has not been made (sec. 410(d)).

The plan administrator is required to provide this generalized notice to each affected participant and each affected alternate payee. For purposes of the Senate amendment, an affected participant or alternate payee is a participant or alternate payee to whom the significant reduction in the rate of future benefit accrual is reasonably expected to apply.

As noted above, the Senate amendment requires the plan administrator to provide a benefit estimation tool kit, no later than 15 days prior to the amendment effective date, to a participant for whom the amendment may reasonably be expected to produce a significant reduction in the rate of future benefit accrual if the amendment is a significant restructuring amendment. The plan administrator is not required to provide this benefit estimation tool kit to any participant who has less than one year of participation in the plan.

The benefit estimation tool kit is designed to enable participants to estimate benefits under the old and new plan provisions. The Senate amendment permits the tool kit to be in the form of software (for use at home, at a workplace kiosk, or on a company intranet), worksheets, or calculation instructions, or other formats to be determined by the Secretary of the Treasury. The tool kit is required to include any necessary actuarial assumptions and formulas and to permit the participant to estimate both a single life annuity at appropriate ages and, when available, a lump sum distribution. The tool kit is required to disclose the interest rate used to compute a lump sum distribution and whether the value of early retirement benefits is included in the lump sum distribution.

The Senate amendment requires the benefit estimation tool kit to accommodate employee-provided variables with respect to age, years of service, retirement age, covered compensation, and interest rate (when variable rates apply). The tool kit is required to permit employees to recalculate estimated benefits by changing the values of these variables. The Senate amendment does not require the tool kit to accommodate employee variables with respect to qualified domestic relations orders, factors that result in unusual patterns of credited service (such as extended time away from the job), special benefit formulas for unusual situations, offsets from other plans, and forms of annuity distributions.

In the case of a significant restructuring amendment that occurs in connection with a business disposition or acquisition transaction and within one year following the date of the transaction, the Senate amendment requires the plan administrator to provide the benefit estimation tool kit prior to the date that is 12 months after the date on which the generalized notice of the amendment is given to the affected participants.

The Senate amendment permits a plan administrator to provide any notice required under the Senate amendment to a person designated in writing by the individual to whom it would otherwise be provided. In addition, the Senate amendment authorizes the Secretary of the Treasury to allow any notice required under the

Senate amendment to be provided by using new technologies, provided that at least one option for providing notice is not dependent upon new technologies.

The Senate amendment imposes on a plan administrator that fails to comply with the notice requirement an excise tax equal to $100 per day per omitted participant and alternate payee. No excise tax is imposed during any period during which any person subject to liability for the tax did not know that the failure existed and exercised reasonable diligence to meet the notice requirement. In addition, no excise tax is imposed on any failure if any person subject to liability for the tax exercised reasonable diligence to meet the notice requirement and such person provides the required notice during the 30-day period beginning on the first date such person knew, or exercising reasonable diligence would have known, that the failure existed. Also, if the person subject to liability for the excise tax exercised reasonable diligence to meet the notice requirement, the total excise tax imposed during a taxable year of the employer will not exceed $500,000. Furthermore, in the case of a failure due to reasonable cause and not to willful neglect, the Secretary of the Treasury is authorized to waive the excise tax to the extent that the payment of the tax is excessive relative to the failure involved.

The Senate amendment directs the Secretary of the Treasury to issue, not later than one year after the date of enactment, regulations with respect to early retirement benefits or retirement-type subsidies, the determination of a significant restructuring amendment, and the examples that are required under the generalized notice and the benefit estimation tool kit.

In addition, the Senate amendment directs the Secretary of the Treasury to prepare a report on the effects of significant restructurings of plan benefit formulas of traditional defined benefit plans. Such study is to examine the effect of such restructurings on longer service participants, including the incidence and effects of "wear away" provisions under which participants earn no additional benefits for a period of time after the restructuring. The Secretary is directed to submit such report, together with recommendations thereon, to the Committee on Ways and Means and the Committee on Education and the Workforce of the House of Representatives and the Committee on Finance and the Committee on Health, Education, Labor, and Pensions of the Senate as soon as practicable, but not later than one year after the date of enactment.

Effective date.—The Senate amendment is effective for plan amendments taking effect on or after the date of enactment. The period for providing any notice required under the Senate amendment will not end before the last day of the three-month period following the date of enactment. Prior to the issuance of Treasury regulations, a plan is treated as meeting the requirements of the Senate amendment if the plan makes a good faith effort to comply with such requirements.

CONFERENCE AGREEMENT

The conference agreement follows the House bill, with the following modifications. The conference agreement also modifies the

present-law notice requirement contained in section 204(h) of Title I of ERISA to provide that an applicable pension plan may not be amended to provide for a significant reduction in the rate of future benefit accrual in the event of an egregious failure by the plan administrator to comply with a notice requirement similar to the notice requirement that the conference agreement adds to the Internal Revenue Code. In addition, the conference agreement expands the current ERISA notice requirement regarding significant reductions in normal retirement benefit accrual rates to early retirement benefits and retirement-type subsidies.

(d) Modifications to section 415 limits for multiemployer plans (sec. 505 of the House bill, sec. 654 of the Senate amendment, and sec. 415 of the Code)

PRESENT LAW

Under present law, limits apply to contributions and benefits under qualified plans (sec. 415). The limits on contributions and benefits under qualified plans are based on the type of plan.

Under a defined benefit plan, the maximum annual benefit payable at retirement is generally the lesser of (1) 100 percent of average compensation for the highest three years, or (2) $140,000 (for 2001). The dollar limit is adjusted for cost-of-living increases in $5,000 increments. The dollar limit is reduced in the case of retirement before the social security retirement age and increases in the case of retirement after the social security retirement age.

A special rule applies to governmental defined benefit plans. In the case of such plans, the defined benefit dollar limit is reduced in the case of retirement before age 62 and increased in the case of retirement after age 65. In addition, there is a floor on early retirement benefits. Pursuant to this floor, the minimum benefit payable at age 55 is $75,000.

In the case of a defined contribution plan, the limit on annual is additions if the lesser of (1) 25 percent of compensation [120] or (2) $35,000 (for 2001).

In applying the limits on contributions and benefits, plans of the same employer are aggregated. That is, all defined benefit plans of the same employer are treated as a single plan, and all defined contribution plans of the same employer are treated as a single plan. Under Treasury regulations, multiemployer plans are not aggregated with other multiemployer plans. However, if an employer maintains both a plan that is not a multiemployer plan and a multiemployer plan, the plan that is not a multiemployer plan is aggregated with the multiemployer plan to the extent that benefits provided under the multiemployer plan are provided with respect to a common participant.[121]

HOUSE BILL

Under the House bill, the 100 percent of compensation defined benefit plan limit does not apply to multiemployer plans. With respect to aggregation of multiemployer plans with other plans, the

[120] Another provision of the House bill increases this limit to 100 percent of compensation.
[121] Treas. Reg. sec. 1.415–8(e).

House bill provides that multiemployer plans are not aggregated with single-employer defined benefit plans maintained by an employer contributing to the multiemployer plan for purposes of applying the 100 percent of compensation limit to such single-employer plan.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill with respect to the waiver of the 100 percent of compensation limit.

With respect to aggregation of multiemployer plans with other plans, multiemployer plans are not aggregated with any other plan maintained by the same employer, except for purposes of applying the dollar limitation on defined plans and the limits on annual additions to a plan that is not a multiemployer plan.

CONFERENCE AGREEMENT

The conference agreement follows the House bill.

(e) Investment of employee contributions in 401(k) plans (sec. 506 of the House bill, sec. 655 of the Senate amendment, and sec. 1524(b) of the Taxpayer Relief Act of 1997)

PRESENT LAW

The Employee Retirement Income Security Act of 1974, as amended ("ERISA") prohibits certain employee benefit plans from acquiring securities or real property of the employer who sponsors the plan if, after the acquisition, the fair market value of such securities and property exceeds 10 percent of the fair market value of plan assets. The 10-percent limitation does not apply to any "eligible individual account plans" that specifically authorize such investments. Generally, eligible individual account plans are defined contribution plans, including plans containing a cash or deferred arrangement ("401(k) plans").

The term "eligible individual account plan" does not include the portion of a plan that consists of elective deferrals (and earnings on the elective deferrals) made under section 401(k) if elective deferrals equal to more than one percent of any employee's eligible compensation are required to be invested in employer securities and employer real property. Eligible compensation is compensation that is eligible to be deferred under the plan. The portion of the plan that consists of elective deferrals (and earnings thereon) is still treated as an individual account plan, and the 10-percent limitation does not apply, as long as elective deferrals (and earnings thereon) are not required to be invested in employer securities or employer real property.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply if individual account plans are a small part of the employer's retirement plans. In particular, that rule does not apply to an individual account plan for a plan year if the value of the assets of all individual account plans maintained by the employer do not exceed 10 percent of the value of the assets of all pension plans maintained

by the employer (determined as of the last day of the preceding plan year). Multiemployer plans are not taken into account in determining whether the value of the assets of all individual account plans maintained by the employer exceed 10 percent of the value of the assets of all pension plans maintained by the employer. The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan does not apply to an employee stock ownership plan as defined in section 4975(e)(7) of the Internal Revenue Code.

The rule excluding elective deferrals (and earnings thereon) from the definition of individual account plan applies to elective deferrals for plan years beginning after December 31, 1998 (and earnings thereon). It does not apply with respect to earnings on elective deferrals for plan years beginning before January 1, 1999.

HOUSE BILL

The House bill modifies the effective date of the rule excluding certain elective deferrals (and earnings thereon) from the definition of individual account plan by providing that the rule does not apply to any elective deferral used to acquire an interest in the income or gain from employer securities or employer real property acquired (1) before January 1, 1999, or (2) after such date pursuant to a written contract which was binding on such date and at all times thereafter.

Effective date.—The House bill is effective as if included in the section of the Taxpayer Relief Act of 1997 that contained the rule excluding certain elective deferrals (and earnings thereon).

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(f) Periodic pension benefit statements (sec. 507 of the House bill and sec. 105(a) of ERISA)

PRESENT LAW

Title I of ERISA provides that a pension plan administrator must furnish a benefit statement to any participant or beneficiary who makes a written request for such a statement. This statement must indicate, on the basis of the latest available information, (1) the participant's or beneficiary's total accrued benefit, and (2) the participant's or beneficiary's vested accrued benefit or the earliest date on which the accrued benefit will become vested. A participant or beneficiary is not entitled to receive more than one benefit statement during any 12-month period. The plan administrator must furnish the benefit statement no later than 60 days after receipt of the request or, if later, 120 days after the close of the immediately preceding plan year.

In addition, the plan administrator must furnish a benefit statement to each participant whose employment terminates or who has a one-year break in service. For purposes of this benefit

statement requirement, a "one-year break in service" is a calendar year, plan year, or other 12-month period designated by the plan during which the participant does not complete more than 500 hours of service for the employer. A participant is not entitled to receive more than one benefit statement with respect to consecutive breaks in service. The plan administrator must provide a benefit statement required upon termination of employment or a break in service no later than 180 days after the end of the plan year in which the termination of employment or break in service occurs.

HOUSE BILL

A plan administrator of a defined contribution plan generally is required to furnish a benefit statement to each participant at least once annually and to a beneficiary upon written request.

In addition to providing a benefit statement to a participant or beneficiary upon written request, the plan administrator of a defined benefit plan generally is required either (1) to furnish a benefit statement at least once every three years to each participant who has a vested accrued benefit and who is employed by the employer at the time the plan administrator furnishes the benefit statements to participants, or (2) to annually furnish written, electronic, telephonic, or other appropriate notice to each participant of the availability of and the manner in which the participant may obtain the benefit statement.

The plan administrator is required to write the benefit statement in a manner calculated to be understood by the average plan participant and is permitted to furnish the statement in written, electronic, telephonic, or other appropriate form.

The Secretary of Labor is authorized to provide that years in which no employee or former employee benefits under a plan need not be taken into account in determining the applicable three-year period.

In addition, the Secretary of Labor is directed to develop a model benefit statement, written in a manner calculated to be understood by the average plan participant, that may be used by plan administrators in complying with the requirements of section 105 of ERISA. The use of the model statement is optional. It is intended that the model statement include items such as the amount of nonforfeitable accrued benefits as of the statement date that are payable at normal retirement age under the plan, the amount of accrued benefits that are forfeitable but that may become nonforfeitable under the terms of the plan, information on how to contact the Social Security Administration to obtain a participant's personal earnings and benefit estimate statement, and other information that may be important to understanding benefits earned under the plan. Statements provided by electronic forms of communications shall be provided consistent with Department of Labor and Department of Treasury regulations.

Effective date.—The provision is effective for plan years beginning after December 31, 2002.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(g) Prohibited allocations of stock in an S corporation ESOP (sec. 508 of the House bill, sec. 656 of the Senate amendment, and secs. 409 and 4979a of the Code)

PRESENT LAW

The Small Business Job Protection Act of 1996 allowed qualified retirement plan trusts described in section 401(a) to own stock in an S corporation. That Act treated the plan's share of the S corporation's income (and gain on the disposition of the stock) as includible in full in the trust's unrelated business taxable income ("UBTI").

The Tax Relief Act of 1997 repealed the provision treating items of income or loss of an S corporation as UBTI in the case of an employee stock ownership plan ("ESOP"). Thus, the income of an S corporation allocable to an ESOP is not subject to current taxation.

Present law provides a deferral of income on the sales of certain employer securities to an ESOP (sec. 1042). A 50-percent excise tax is imposed on certain prohibited allocations of securities acquired by an ESOP in a transaction to which section 1042 applies. In addition, such allocations are currently includible in the gross income of the individual receiving the prohibited allocation.

HOUSE BILL

In general

Under the House bill, if there is a nonallocation year with respect to an ESOP maintained by an S corporation: (1) the amount allocated in a prohibited allocation to an individual who is a disqualified person is treated as distributed to such individual (i.e., the value of the prohibited allocation is includible in the gross income of the individual receiving the prohibited allocation); (2) an excise tax is imposed on the S corporation equal to 50 percent of the amount involved in a prohibited allocation; and (3) an excise tax is imposed on the S corporation with respect to any synthetic equity owned by a disqualified person.[122]

It is intended that the House bill will limit the establishment of ESOPs by S corporations to those that provide broad-based employee coverage and that benefit rank-and-file employees as well as highly compensated employees and historical owners.

Definition of nonallocation year

A nonallocation year means any plan year of an ESOP holding shares in an S corporation if, at any time during the plan year, disqualified persons own at least 50 percent of the number of outstanding shares of the S corporation.

A person is a disqualified person if the person is either (1) a member of a "deemed 20-percent shareholder group" or (2) a "deemed 10-percent shareholder." A person is a member of a

[122] The plan is not disqualified merely because an excise tax is imposed under the provision.

"deemed 20-percent shareholder group" if the aggregate number of deemed-owned shares of the person and his or her family members is at least 20 percent of the number of deemed-owned shares of stock in the S corporation.[123] A person is a deemed 10-percent shareholder if the person is not a member of a deemed 20-percent shareholder group and the number of the person's deemed-owned shares is at least 10 percent of the number of deemed-owned shares of stock of the corporation.

In general, "deemed-owned shares" means: (1) stock allocated to the account of an individual under the ESOP, and (2) an individual's share of unallocated stock held by the ESOP. An individual's share of unallocated stock held by an ESOP is determined in the same manner as the most recent allocation of stock under the terms of the plan.

For purposes of determining whether there is a nonallocation year, ownership of stock generally is attributed under the rules of section 318,[124] except that: (1) the family attribution rules are modified to include certain other family members, as described below, (2) option attribution does not apply (but instead special rules relating to synthetic equity described below apply), and (3) "deemed-owned shares" held by the ESOP are treated as held by the individual with respect to whom they are deemed owned.

Under the House bill, family members of an individual include (1) the spouse[125] of the individual, (2) an ancestor or lineal descendant of the individual or his or her spouse, (3) a sibling of the individual (or the individual's spouse) and any lineal descendant of the brother or sister, and (4) the spouse of any person described in (2) or (3).

The House bill contains special rules applicable to synthetic equity interests. Except to the extent provided in regulations, the stock on which a synthetic equity interest is based are treated as outstanding stock of the S corporation and as deemed-owned shares of the person holding the synthetic equity interest if such treatment will result in the treatment of any person as a disqualified person or the treatment of any year as a nonallocation year. Thus, for example, disqualified persons for a year include those individuals who are disqualified persons under the general rule (i.e., treating only those shares held by the ESOP as deemed-owned shares) and those individuals who are disqualified individuals if synthetic equity interests are treated as deemed-owned shares.

"Synthetic equity" means any stock option, warrant, restricted stock, deferred issuance stock right, or similar interest that gives the holder the right to acquire or receive stock of the S corporation in the future. Except to the extent provided in regulations, synthetic equity also includes a stock appreciation right, phantom

[123] A family member of a member of a "deemed 20-percent shareholder group" with deemed owned shares is also treated as a disqualified person.

[124] These attribution rules also apply to stock treated as owned by reason of the ownership of synthetic equity.

[125] As under section 318, an individual's spouse is not treated as a member of the individual's family if the spouses are legally separated.

stock unit, or similar right to a future cash payment based on the value of such stock or appreciation in such value.[126]

Ownership of synthetic equity is attributed in the same manner as stock is attributed under the House bill (as described above). In addition, ownership of synthetic equity is attributed under the rules of section 318(a)(2) and (3) in the same manner as stock.

Definition of prohibited allocation

An ESOP of an S corporation is required to provide that no portion of the assets of the plan attributable to (or allocable in lieu of) S corporation stock may, during a nonallocation year, accrue (or be allocated directly or indirectly under any qualified plan of the S corporation) for the benefit of a disqualified person. A "prohibited allocation" refers to violations of this provision. A prohibited allocation occurs, for example, if income on S corporation stock held by an ESOP is allocated to the account of an individual who is a disqualified person.

Application of excise tax

In the case of a prohibited allocation, the S corporation is liable for an excise tax equal to 50 percent of the amount of the allocation. For example, if S corporation stock is allocated in a prohibited allocation, the excise tax is equal to 50 percent of the fair market value of such stock.

A special rule applies in the case of the first nonallocation year, regardless of whether there is a prohibited allocation. In that year, the excise tax also applies to the fair market value of the deemed-owned shares of any disqualified person held by the ESOP, even though those shares are not allocated to the disqualified person in that year.

As mentioned above, the S corporation also is liable for an excise tax with respect to any synthetic equity interest owned by any disqualified person in a nonallocation year. The excise tax is 50 percent of the value of the shares on which synthetic equity is based.

Treasury regulations

The Treasury Department is given the authority to prescribe such regulations as may be necessary to carry out the purposes of the House bill.

Effective date.—The House bill generally is effective with respect to plan years beginning after December 31, 2004. In the case of an ESOP established after March 14, 2001, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the House bill is effective with respect to plan years ending after March 14, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with a modification of the effective date.

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[126] The provisions relating to synthetic equity do not modify the rules relating to S corporations, e.g., the circumstances in which options or similar interests are treated as creating a second class of stock.

Effective date.—The Senate amendment generally is effective with respect to plan years beginning after December 31, 2002. In the case of an ESOP established after July 11, 2000, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the Senate amendment is effective with respect to plan years ending after July 11, 2000.

CONFERENCE AGREEMENT

The conference agreement follows the House bill. The conference agreement authorizes the Secretary to determine, by regulation or other guidance of general applicability, that a nonallocation year occurs in any case in which the principal purpose of the ownership structure of an S corporation constitutes, in substance, an avoidance or evasion of the prohibited allocation rules. For example, this might apply if more than 10 independent businesses are combined in an S corporation owned by an ESOP in order to take advantage of the income tax treatment of S corporations owned by an ESOP.

(h) Automatic rollovers of certain mandatory distributions (sec. 657 of the Senate amendment and secs. 401(a)(31) and 402(f)(1) of the Code and sec. 404(c) of ERISA)

PRESENT LAW

If a qualified retirement plan participant ceases to be employed by the employer that maintains the plan, the plan may distribute the participant's nonforfeitable accrued benefit without the consent of the participant and, if applicable, the participant's spouse, if the present value of the benefit does not exceed $5,000. If such an involuntary distribution occurs and the participant subsequently returns to employment covered by the plan, then service taken into account in computing benefits payable under the plan after the return need not include service with respect to which a benefit was involuntarily distributed unless the employee repays the benefit.

Generally, a participant may roll over an involuntary distribution from a qualified plan to an IRA or to another qualified plan. Before making a distribution that is eligible for rollover, a plan administrator must provide the participant with a written explanation of the ability to have the distribution rolled over directly to an IRA or another qualified plan and the related tax consequences.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment makes a direct rollover the default option for involuntary distributions that exceed $1,000 and that are eligible rollover distributions from qualified retirement plans. The distribution must be rolled over automatically to a designated IRA, unless the participant affirmatively elects to have the distribution transferred to a different IRA or a qualified plan or to receive it directly.

The written explanation provided by the plan administrator is required to explain that an automatic direct rollover will be made

unless the participant elects otherwise. The plan administrator is also required to notify the participant in writing (as part of the general written explanation or separately) that the distribution may be transferred without cost to another IRA.

The Senate amendment amends the fiduciary rules of ERISA so that, in the case of an automatic direct rollover, the participant is treated as exercising control over the assets in the IRA upon the earlier of (1) the rollover of any portion of the assets to another IRA, or (2) one year after the automatic rollover.

The Senate amendment directs the Secretary of Labor to issue safe harbors under which the designation of an institution and investment of funds in accordance with the Senate amendment are deemed to satisfy the requirements of section 404(a) of ERISA. In addition, the Senate amendment authorizes and directs the Secretary of the Treasury and the Secretary of Labor to give consideration to providing special relief with respect to the use of low-cost individual retirement plans for purposes of the provision and for other uses that promote the preservation of tax-qualified retirement assets for retirement income purposes.

Effective date.—The Senate amendment applies to distributions that occur after the Department of Labor has adopted final regulations implementing the Senate amendment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with modifications. The conference agreement directs the Secretary of Labor to adopt final regulations implementing the conference agreement not later than three years after the date of enactment.

(i) Clarification of treatment of contributions to a multiemployer plan (sec. 658 of the bill)

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, 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).[127]

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 that involves the proper time for the inclusion of the item in income or taking of a deduction.[128] 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 that does not in-

[127] Section 404(a)(6).
[128] Treas. Reg. sec. 1.446–1(e)(2)(ii)(a).

volve 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.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment clarifies that a determination of whether contributions 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 multiemployer plans as provided in section 404(a)(6) has not changed its method of accounting and is not subject to an adjustment under section 481. The Senate amendment is intended to respect, not disturb, the effect of the statute of limitations. The Senate amendment is not 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 is authorized to promulgate regulations to clarify that, in the aggregate, no taxpayer will be permitted deductions in excess of amounts actually contributed to multiemployer plans, taking into account the provisions of section 404(a)(6).

No inference is intended regarding whether the determination of whether a contribution to a multiemployer pension plan on account of a prior year under section 404(a)(6) is a method of accounting prior to the effective date of the provision.

Effective date.—The Senate amendment is effective after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

5. Reducing regulatory burdens

(a) Modification of timing of plan valuations (sec. 601 of the House bill, sec. 661 of the Senate amendment, and sec. 412 of the Code)

PRESENT LAW

Under present law, plan valuations are generally required annually for plans subject to the minimum funding rules. Under proposed Treasury regulations, except as provided by the Commissioner, the valuation must be as of a date within the plan year to which the valuation refers or within the month prior to the beginning of that year.[129]

HOUSE BILL

The House bill incorporates into the statute the proposed regulation regarding the date of valuations. The House bill also pro-

[129] Prop. Treas. Reg. sec. 1.412(c)(9)–1(b)(1).

vides, as an exception to this general rule, that the valuation date with respect to a plan year may be any date within the immediately preceding plan year if, as of such date, plan assets are not less than 125 percent of the plan's current liability. Information determined as of such date is required to be adjusted actuarially, in accordance with Treasury regulations, to reflect significant differences in plan participants. An election to use a prior plan year valuation date, once made, may only be revoked with the consent of the Secretary.

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement incorporates into the statute the proposed regulation regarding the date of valuations. The conference agreement also provides, as an exception to this general rule, that the valuation date with respect to a plan year may be any date within the immediately preceding plan year if, as of such date, plan assets are not less than 100 percent of the plan's current liability. Information determined as of such date is required to be adjusted actuarially, in accordance with Treasury regulations, to reflect significant differences in plan participants. A change in funding method to take advantage of the exception to the general rule may not be made unless, as of such date, plan assets are not less than 125 percent of the plan's current liability. The Secretary is directed to automatically approve changes in funding method to use a prior year valuation date if the change is within the first three years that the plan is eligible to make the change.

(b) ESOP dividends may be reinvested without loss of dividend deduction (sec. 602 of the House bill, sec. 662 of the Senate amendment, and sec. 404 of the Code)

PRESENT LAW

An employer is entitled to deduct certain dividends paid in cash during the employer's taxable year with respect to stock of the employer that is held by an employee stock ownership plan ("ESOP"). The deduction is allowed with respect to dividends that, in accordance with plan provisions, are (1) paid in cash directly to the plan participants or their beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) used to make payments on loans (including payments of interest as well as principal) that were used to acquire the employer securities (whether or not allocated to participants) with respect to which the dividend is paid.

The Secretary may disallow the deduction for any ESOP dividend if he determines that the dividend constitutes, in substance, an evasion of taxation (sec. 404(k)(5)).

HOUSE BILL

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities.

The House bill permits the Secretary to disallow the deduction for any ESOP dividend if the Secretary determines that the dividend constitutes, in substance, the avoidance or evasion of taxation.

Effective date.—The House bill is effective for taxable years beginning after December 31, 2001.

SENATE AMENDMENT

In addition to the deductions permitted under present law for dividends paid with respect to employer securities that are held by an ESOP, an employer is entitled to deduct the applicable percentage of dividends that, at the election of plan participants or their beneficiaries, are (1) payable in cash directly to plan participants or beneficiaries, (2) paid to the plan and subsequently distributed to the participants or beneficiaries in cash no later than 90 days after the close of the plan year in which the dividends are paid to the plan, or (3) paid to the plan and reinvested in qualifying employer securities. The applicable percentage is 25 percent for 2002 through 2004, 50 percent for 2005 through 2007, 75 percent for 2008 through 2010 and 100 percent for 2011 and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the House bill. The provision of the conference agreement that authorizes the Secretary to disallow the deduction for any ESOP dividend if the Secretary determines that the dividend constitutes, in substance, the avoidance or evasion of taxation includes authority to disallow a deduction of unreasonable dividends. For purposes of the section 404(k)(2)(A)(iii) reinvested dividends, a dividend paid on common stock that is primarily and regularly traded on an established securities market would be reasonable. In addition, for this purpose in the case of employers with no common stock (determined on a controlled group basis) that is primarily and regularly traded on an established securities market, the reasonableness of a dividend is determined by comparing the dividend rate on stock held by the ESOP with the dividend rate for common stock of comparable corporations whose stock is primarily and regularly traded on an established securities market. Whether a corporation is comparable is determined by comparing relevant corporate characteristics such as industry, corporate size, earnings, debt-equity structure and dividend history.

(c) Repeal transition rule relating to certain highly compensated employees (sec. 603 of the House bill, sec. 663 of the Senate amendment, and sec. 1114(c)(4) of the Tax Reform Act of 1986)

PRESENT LAW

Under present law, for purposes of the rules relating to qualified plans, a highly compensated employee is generally defined as an employee[130] who (1) was a five-percent owner of the employer at any time during the year or the preceding year or (2) either (a) had compensation for the preceding year in excess of $85,000 (for 2001) or (b) at the election of the employer, had compensation in excess of $85,000 for the preceding year and was in the top 20 percent of employees by compensation for such year.

Under a rule enacted in the Tax Reform Act of 1986, a special definition of highly compensated employee applies for purposes of the nondiscrimination rules relating to qualified cash or deferred arrangements ("section 401(k) plans") and matching contributions. This special definition applies to an employer incorporated on December 15, 1924, that meets certain specific requirements.

HOUSE BILL

The House bill repeals the special definition of highly compensated employee under the Tax Reform Act of 1986. Thus, the present-law definition applies.

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(d) Employees of tax-exempt entities (sec. 604 of the House bill and sec. 664 of the Senate amendment)

PRESENT LAW

The Tax Reform Act of 1986 provided that nongovernmental tax-exempt employers were not permitted to maintain a qualified cash or deferred arrangement ("section 401(k) plan"). This prohibition was repealed, effective for years beginning after December 31, 1996, by the Small Business Job Protection Act of 1996.

Treasury regulations provide that, in applying the nondiscrimination rules to a section 401(k) plan (or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan), the employer may treat as excludable those employees of a tax-exempt entity who could not participate in the arrangement due to the prohibition on maintenance of a section 401(k) plan by such entities. Such employees may be disregarded only if more than 95 percent of the employees who could partici-

[130] An employee includes a self-employed individual.

pate in the section 401(k) plan benefit under the plan for the plan year.[131]

Tax-exempt charitable organizations may maintain a tax-sheltered annuity (a "section 403(b) annuity") that allows employees to make salary reduction contributions.

HOUSE BILL

The Treasury Department is directed to revise its regulations under section 410(b) to provide that employees of a tax-exempt charitable organization who are eligible to make salary reduction contributions under a section 403(b) annuity may be treated as excludable employees for purposes of testing a section 401(k) plan, or a section 401(m) plan that is provided under the same general arrangement as the section 401(k) plan of the employer if (1) no employee of such tax-exempt entity is eligible to participate in the section 401(k) or 401(m) plan and (2) at least 95 percent of the employees who are not employees of the charitable employer are eligible to participate in such section 401(k) plan or section 401(m) plan.

The revised regulations are to be effective for years beginning after December 31, 1996.

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(e) Treatment of employer-provided retirement advice (sec. 605 of the House bill, sec. 665 of the Senate amendment, and sec. 132 of the Code)

PRESENT LAW

Under present law, certain employer-provided fringe benefits are excludable from gross income (sec. 132) and wages for employment tax purposes. These excludable fringe benefits include working condition fringe benefits and de minimis fringes. In general, a working condition fringe benefit is any property or services provided by an employer to an employee to the extent that, if the employee paid for such property or services, such payment would be allowable as a deduction as a business expense. A de minimis fringe benefit is any property or services provided by the employer the value of which, after taking into account the frequency with which similar fringes are provided, is so small as to make accounting for it unreasonable or administratively impracticable.

In addition, if certain requirements are satisfied, up to $5,250 annually of employer-provided educational assistance is excludable from gross income (sec. 127) and wages. This exclusion expires with

[131] Treas. Reg. sec. 1.410(b)–6(g).

respect to courses beginning after December 31, 2001.[132] Education not excludable under section 127 may be excludable as a working condition fringe.

There is no specific exclusion under present law for employer-provided retirement planning services. However, such services may be excludable as employer-provided educational assistance or a fringe benefit.

HOUSE BILL

Qualified retirement planning services provided to an employee and his or her spouse by an employer maintaining a qualified plan are excludable from income and wages. The exclusion does not apply with respect to highly compensated employees unless the services are available on substantially the same terms to each member of the group of employees normally provided education and information regarding the employer's qualified plan. "Qualified retirement planning services" are retirement planning advice and information. The exclusion is not limited to information regarding the qualified plan, and, thus, for example, applies to advice and information regarding retirement income planning for an individual and his or her spouse and how the employer's plan fits into the individual's overall retirement income plan. On the other hand, the exclusion does not apply to services that may be related to retirement planning, such as tax preparation, accounting, legal or brokerage services.

It is intended that the House bill will clarify the treatment of retirement advice provided in a nondiscriminatory manner. It is intended that the Secretary, in determining the application of the exclusion to highly compensated employees, may permit employers to take into consideration employee circumstances other than compensation and position in providing advice to classifications of employees. Thus, for example, the Secretary may permit employers to limit certain advice to individuals nearing retirement age under the plan.

Effective date.—The House bill is effective with respect to years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(f) Reporting simplification (sec. 606 of the House bill and sec. 666 of the Senate amendment)

PRESENT LAW

A plan administrator of a pension, annuity, stock bonus, profit-sharing or other funded plan of deferred compensation generally must file with the Secretary of the Treasury an annual return for each plan year containing certain information with respect to the

[132] The exclusion does not apply with respect to graduate-level courses.

qualification, financial condition, and operation of the plan. Title I of ERISA also may require the plan administrator to file annual reports concerning the plan with the Department of Labor and the Pension Benefit Guaranty Corporation ("PBGC"). The plan administrator must use the Form 5500 series as the format for the required annual return.[133] The Form 5500 series annual return/report, which consists of a primary form and various schedules, includes the information required to be filed with all three agencies. The plan administrator satisfies the reporting requirement with respect to each agency by filing the Form 5500 series annual return/report with the Department of Labor, which forwards the form to the Internal Revenue Service and the PBGC.

The Form 5500 series consists of two different forms: Form 5500 and Form 5500–EZ. Form 5500 is the more comprehensive of the forms and requires the most detailed financial information. A plan administrator generally may file Form 5500–EZ, which consists of only one page, if (1) the only participants in the plan are the sole owner of a business that maintains the plan (and such owner's spouse), or partners in a partnership that maintains the plan (and such partners' spouses), (2) the plan is not aggregated with another plan in order to satisfy the minimum coverage requirements of section 410(b), (3) the employer is not a member of a related group of employers, and (4) the employer does not receive the services of leased employees. If the plan satisfies the eligibility requirements for Form 5500–EZ and the total value of the plan assets as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed $100,000, the plan administrator is not required to file a return.

With respect to a plan that does not satisfy the eligibility requirements for Form 5500–EZ, the characteristics and the size of the plan determine the amount of detailed financial information that the plan administrator must provide on Form 5500. If the plan has more than 100 participants at the beginning of the plan year, the plan administrator generally must provide more information.

HOUSE BILL

The Secretary of the Treasury is directed to modify the annual return filing requirements with respect to plans that satisfy the eligibility requirements for Form 5500–EZ to provide that if the total value of the plan assets of such a plan as of the end of the plan year and all prior plan years beginning on or after January 1, 1994, does not exceed $250,000, the plan administrator is not required to file a return. In addition, the House bill directs the Secretary of the Treasury and the Secretary of Labor to provide simplified reporting requirements for certain plans with fewer than 25 employees.

Effective date.—The House bill is effective on January 1, 2002.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment does not include the direction to the Secretary of the Treasury and the Secretary of

[133] Treas. Reg. sec. 301.6058–1(a).

Labor to provide simplified reporting requirements for certain plans with fewer than 25 employees.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(g) Improvement to Employee Plans Compliance Resolution System (sec. 607 of the House bill and sec. 667 of the Senate amendment)

PRESENT LAW

A retirement plan that is intended to be a tax-qualified plan provides retirement benefits on a tax-favored basis if the plan satisfies all of the requirements of section 401(a). Similarly, an annuity that is intended to be a tax-sheltered annuity provides retirement benefits on a tax-favored basis if the program satisfies all of the requirements of section 403(b). Failure to satisfy all of the applicable requirements of section 401(a) or section 403(b) may disqualify a plan or annuity for the intended tax-favored treatment.

The Internal Revenue Service ("IRS") has established the Employee Plans Compliance Resolution System ("EPCRS"), which is a comprehensive system of correction programs for sponsors of retirement plans and annuities that are intended, but have failed, to satisfy the requirements of section 401(a), section 403(a), or section 403(b), as applicable.[134] EPCRS permits employers to correct compliance failures and continue to provide their employees with retirement benefits on a tax-favored basis.

The IRS has designed EPCRS to (1) encourage operational and formal compliance, (2) promote voluntary and timely correction of compliance failures, (3) provide sanctions for compliance failures identified on audit that are reasonable in light of the nature, extent, and severity of the violation, (4) provide consistent and uniform administration of the correction programs, and (5) permit employers to rely on the availability of EPCRS in taking corrective actions to maintain the tax-favored status of their retirement plans and annuities.

The basic elements of the programs that comprise EPCRS are self-correction, voluntary correction with IRS approval, and correction on audit. The Self-Correction Program ("SCP") generally permits a plan sponsor that has established compliance practices to correct certain insignificant failures at any time (including during an audit), and certain significant failures within a two-year period, without payment of any fee or sanction. The Voluntary Correction Program ("VCP") program permits an employer, at any time before an audit, to pay a limited fee and receive IRS approval of a correction. For a failure that is discovered on audit and corrected, the Audit Closing Agreement Program ("Audit CAP") provides for a sanction that bears a reasonable relationship to the nature, extent, and severity of the failure and that takes into account the extent to which correction occurred before audit.

[134] Rev. Proc. 2001–17, 2001–7 I.R.B. 589.

The IRS has expressed its intent that EPCRS will be updated and improved periodically in light of experience and comments from those who use it.

HOUSE BILL

The Secretary of the Treasury is directed to continue to update and improve EPCRS, giving special attention to (1) increasing the awareness and knowledge of small employers concerning the availability and use of EPCRS, (2) taking into account special concerns and circumstances that small employers face with respect to compliance and correction of compliance failures, (3) extending the duration of the self-correction period under SCP for significant compliance failures, (4) expanding the availability to correct insignificant compliance failures under SCP during audit, and (5) assuring that any tax, penalty, or sanction that is imposed by reason of a compliance failure is not excessive and bears a reasonable relationship to the nature, extent, and severity of the failure.

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(h) Repeal of the multiple use test (sec. 608 of the House bill, sec. 668 of the Senate amendment, and sec. 401(m) of the Code)

PRESENT LAW

Elective deferrals under a qualified cash or deferred arrangement ("section 401(k) plan") are subject to a special annual nondiscrimination test ("ADP test"). The ADP test compares the actual deferral percentages ("ADPs") of the highly compensated employee group and the nonhighly compensated employee group. The ADP for each group generally is the average of the deferral percentages separately calculated for the employees in the group who are eligible to make elective deferrals for all or a portion of the relevant plan year. Each eligible employee's deferral percentage generally is the employee's elective deferrals for the year divided by the employee's compensation for the year.

The plan generally satisfies the ADP test if the ADP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ADP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ADP of the nonhighly compensated employee group for the prior plan year and not more than two percentage points greater than the ADP of the nonhighly compensated employee group for the prior plan year.

Employer matching contributions and after-tax employee contributions under a defined contribution plan also are subject to a special annual nondiscrimination test ("ACP test"). The ACP test

compares the actual deferral percentages ("ACPs") of the highly compensated employee group and the nonhighly compensated employee group. The ACP for each group generally is the average of the contribution percentages separately calculated for the employees in the group who are eligible to make after-tax employee contributions or who are eligible for an allocation of matching contributions for all or a portion of the relevant plan year. Each eligible employee's contribution percentage generally is the employee's aggregate after-tax employee contributions and matching contributions for the year divided by the employee's compensation for the year.

The plan generally satisfies the ACP test if the ACP of the highly compensated employee group for the current plan year is either (1) not more than 125 percent of the ACP of the nonhighly compensated employee group for the prior plan year, or (2) not more than 200 percent of the ACP of the nonhighly compensated employee group for the prior plan year and not more than two percentage points greater than the ACP of the nonhighly compensated employee group for the prior plan year.

For any year in which (1) at least one highly compensated employee is eligible to participate in an employer's plan or plans that are subject to both the ADP test and the ACP test, (2) the plan subject to the ADP test satisfies the ADP test but the ADP of the highly compensated employee group exceeds 125 percent of the ADP of the nonhighly compensated employee group, and (3) the plan subject to the ACP test satisfies the ACP test but the ACP of the highly compensated employee group exceeds 125 percent of the ACP of the nonhighly compensated employee group, an additional special nondiscrimination test ("multiple use test") applies to the elective deferrals, employer matching contributions, and after-tax employee contributions. The plan or plans generally satisfy the multiple use test if the sum of the ADP and the ACP of the highly compensated employee group does not exceed the greater of (1) the sum of (A) 1.25 times the greater of the ADP or the ACP of the nonhighly compensated employee group, and (B) two percentage points plus (but not more than two times) the lesser of the ADP or the ACP of the nonhighly compensated employee group, or (2) the sum of (A) 1.25 times the lesser of the ADP or the ACP of the nonhighly compensated employee group, and (B) two percentage points plus (but not more than two times) the greater of the ADP or the ACP of the nonhighly compensated employee group.

HOUSE BILL

The House bill repeals the multiple use test.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement follows the House bill and the Senate amendment.

(i) Flexibility in nondiscrimination, coverage, and line of business rules (sec. 609 of the House bill, sec. 669 of the Senate amendment, and secs. 401(a)(4), 410(b), and 414(r) of the Code)

PRESENT LAW

A plan is not a qualified retirement plan if the contributions or benefits provided under the plan discriminate in favor of highly compensated employees (sec. 401(a)(4)). The applicable Treasury regulations set forth the exclusive rules for determining whether a plan satisfies the nondiscrimination requirement. These regulations state that the form of the plan and the effect of the plan in operation determine whether the plan is nondiscriminatory and that intent is irrelevant.

Similarly, a plan is not a qualified retirement plan if the plan does not benefit a minimum number of employees (sec. 410(b)). A plan satisfies this minimum coverage requirement if and only if it satisfies one of the tests specified in the applicable Treasury regulations. If an employer is treated as operating separate lines of business, the employer may apply the minimum coverage requirements to a plan separately with respect to the employees in each separate line of business (sec. 414(r)). Under a so-called "gateway" requirement, however, the plan must benefit a classification of employees that does not discriminate in favor of highly compensated employees in order for the employer to apply the minimum coverage requirements separately for the employees in each separate line of business. A plan satisfies this gateway requirement only if it satisfies one of the tests specified in the applicable Treasury regulations.

HOUSE BILL

The Secretary of the Treasury is directed to modify, on or before December 31, 2003, the existing regulations issued under section 414(r) in order to expand (to the extent that the Secretary may determine to be appropriate) the ability of a plan to demonstrate compliance with the line of business requirements based upon the facts and circumstances surrounding the design and operation of the plan, even though the plan is unable to satisfy the mechanical tests currently used to determine compliance.

The Secretary of the Treasury is directed to provide by regulation applicable to years beginning after December 31, 2003, that a plan is deemed to satisfy the nondiscrimination requirements of section 401(a)(4) if the plan satisfies the pre-1994 facts and circumstances test, satisfies the conditions prescribed by the Secretary to appropriately limit the availability of such test, and is submitted to the Secretary for a determination of whether it satisfies such test (to the extent provided by the Secretary).

Similarly, a plan complies with the minimum coverage requirement of section 410(b) if the plan satisfies the pre-1989 coverage rules, is submitted to the Secretary for a determination of whether it satisfies the pre-1989 coverage rules (to the extent provided by the Secretary), and satisfies conditions prescribed by the Secretary by regulation that appropriately limit the availability of the pre-1989 coverage rules.

Effective date.—The provision of the House bill relating to the line of business requirements under section 414(r) is effective on the date of enactment. The provision relating to the nondiscrimination requirements under section 401(a)(4) is effective on the date of enactment, except that any condition of availability prescribed by the Secretary is not effective before the first year beginning not less than 120 days after the date on which such condition is prescribed. The provision relating to the minimum coverage requirements under section 410(b) is effective for years beginning after December 31, 2003, except that any condition of availability prescribed by the Secretary by regulation does not apply before the first year beginning not less than 120 days after the date on which such condition is prescribed.

SENATE AMENDMENT

The Senate amendment is the same as the House bill, with the following modification. The Senate amendment provides that the regulations required with respect to the nondiscrimination requirements of section 401(a)(4) are to be applicable to plan years beginning after December 31, 2001, and that the regulations required with respect to the line of business requirements of section 414(r) are to be issued by December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(j) Extension to all governmental plans of moratorium on application of certain nondiscrimination rules applicable to state and local government plans (sec. 610 of the House bill, sec. 670 of the Senate amendment, sec. 1505 of the Taxpayer Relief Act of 1997, and secs. 401(a) and 401(k) of the Code)

PRESENT LAW

A qualified retirement plan maintained by a State or local government is exempt from the rules concerning nondiscrimination (sec. 401(a)(4)) and minimum participation (sec. 401(a)(26)). All other governmental plans are not exempt from the nondiscrimination and minimum participation rules.

HOUSE BILL

The House bill exempts all governmental plans (as defined in sec. 414(d)) from the nondiscrimination and minimum participation rules.

Effective date.—The House bill is effective for plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(k) Notice and consent period regarding distributions (sec. 611 of the House bill and sec. 417 of the Code)

PRESENT LAW

Notice and consent requirements apply to certain distributions from qualified retirement plans. These requirements relate to the content and timing of information that a plan must provide to a participant prior to a distribution, and to whether the plan must obtain the participant's consent to the distribution. The nature and extent of the notice and consent requirements applicable to a distribution depend upon the value of the participant's vested accrued benefit and whether the joint and survivor annuity requirements (sec. 417) apply to the participant.[135]

If the present value of the participant's vested accrued benefit exceeds $5,000, the plan may not distribute the participant's benefit without the written consent of the participant. The participant's consent to a distribution is not valid unless the participant has received from the plan a notice that contains a written explanation of (1) the material features and the relative values of the optional forms of benefit available under the plan, (2) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (3) the rules concerning the taxation of a distribution. If the joint and survivor annuity requirements apply to the participant, this notice also must contain a written explanation of (1) the terms and conditions of the qualified joint and survivor annuity ("QJSA"), (2) the participant's right to make, and the effect of, an election to waive the QJSA, (3) the rights of the participant's spouse with respect to a participant's waiver of the QJSA, and (4) the right to make, and the effect of, a revocation of a waiver of the QJSA. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

If the participant's vested accrued benefit does not exceed $5,000, the terms of the plan may provide for distribution without the participant's consent. The plan generally is required, however, to provide to the participant a notice that contains a written explanation of (1) the participant's right, if any, to have the distribution directly transferred to another retirement plan or IRA, and (2) the rules concerning the taxation of a distribution. The plan generally must provide this notice to the participant no less than 30 and no more than 90 days before the date distribution commences.

HOUSE BILL

A qualified retirement plan is required to provide the applicable distribution notice no less than 30 days and no more than 180 days before the date distribution commences. The Secretary of the Treasury is directed to modify the applicable regulations to reflect the extension of the notice period to 180 days and to provide that

[135] Similar provisions are contained in Title I of ERISA.

the description of a participant's right, if any, to defer receipt of a distribution shall also describe the consequences of failing to defer such receipt.

Effective date.—The House bill is effective for years beginning after December 31, 2001.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(l) Annual report dissemination (sec. 612 of the House bill and sec. 104(b)(3) of ERISA)

PRESENT LAW

Title I of ERISA generally requires the plan administrator of each employee pension benefit plan and each employee welfare benefit plan to file an annual report concerning the plan with the Secretary of Labor within seven months after the end of the plan year. Within nine months after the end of the plan year, the plan administrator generally must furnish to each participant and to each beneficiary receiving benefits under the plan a summary of the annual report filed with the Secretary of Labor for the plan year.

HOUSE BILL

The requirement that a plan administrator furnish a summary annual report is satisfied if the report is made reasonably available through electronic means or other new technology. The interpretation of the House bill is to be consistent with the regulations of the Department of Labor and the Department of the Treasury.

Effective date.—The House bill is effective for reports for years beginning after December 31, 2000.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(m) Modifications to the SAVER Act (sec. 613 of the House bill and sec. 517 of ERISA)

PRESENT LAW

The Savings Are Vital to Everyone's Retirement ("SAVER") Act initiated a public-private partnership to educate American workers about retirement savings and directed the Department of Labor to maintain an ongoing program of public information and outreach. The Act also convened a National Summit on Retirement Savings held June 4–5, 1998, and to be held again in 2001 and 2005, co-hosted by the President and the bipartisan Congressional leadership. The National Summit brings together experts in the fields of

employee benefits and retirement savings, key leaders of government, and interested parties from the private sector and general public. The delegates are selected by the Congressional leadership and the President. The National Summit is a public-private partnership, receiving substantial funding from private sector contributions. The goals of the National Summits are to: (1) advance the public's knowledge and understanding of retirement savings and facilitate the development of a broad-based, public education program; (2) identify the barriers which hinder workers from setting aside adequate savings for retirement and impede employers, especially small employers, from assisting their workers in accumulating retirement savings; and (3) develop specific recommendations for legislative, executive, and private sector actions to promote retirement income savings among American workers.

HOUSE BILL

The House bill clarifies that future National Summits on Retirement Savings are to be held in the month of September in 2001 and 2005, and adds an additional National Summit in 2009. To facilitate the administration of future National Summits, the Department of Labor is given authority to enter into cooperative agreements (pursuant to the Federal Grant and Cooperative Agreement Act of 1977) with its 1999 summit partner, the American Savings Education Council.

Six new statutory delegates are added to future National Summits: the Chairman and Ranking Member of the House Ways and Means Committee, the Senate Finance Committee, and the Subcommittee on Employer-Employee Relations of the House Committee on Education and the Workforce. Further, the President, in consultation with the Congressional leadership, may appoint up to three percent of the delegates (not to exceed 10) from a list of nominees provided by the private sector partner in Summit administration. The provision also clarifies that new delegates are to be appointed for each future National Summit (as was the intent of the original legislation) and sets deadlines for their appointment.

The provision also sets deadlines for the Department of Labor to publish the Summit agenda, gives the Department of Labor limited reception and representation authority, and mandates that the Department of Labor consult with the Congressional leadership in drafting the post-Summit report.

Effective date.—The provision is effective on the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

6. Other ERISA provisions

(a) Extension of PBGC missing participants program (sec. 701 of the House bill, sec. 681 of the Senate amendment, and secs. 206(f) and 4050 of ERISA)

PRESENT LAW

The plan administrator of a defined benefit pension plan that is subject to Title IV of ERISA, is maintained by a single employer, and terminates under a standard termination is required to distribute the assets of the plan. With respect to a participant whom the plan administrator of a single employer plan cannot locate after a diligent search, the plan administrator satisfies the distribution requirement only by purchasing irrevocable commitments from an insurer to provide all benefit liabilities under the plan or transferring the participant's designated benefit to the Pension Benefit Guaranty Corporation ("PBGC"), which holds the benefit of the missing participant as trustee until the PBGC locates the missing participant and distributes the benefit.

The PBGC missing participant program is not available to multiemployer plans or defined contribution plans and other plans not covered by Title IV of ERISA.

HOUSE BILL

The PBGC is directed to prescribe for terminating multiemployer plans rules similar to the present-law missing participant rules applicable to terminating single-employer plans that are subject to Title IV of ERISA.

In addition, plan administrators of certain types of plans not subject to the PBGC termination insurance program under present law are permitted, but not required, to elect to transfer missing participants' benefits to the PBGC upon plan termination. Specifically, the House bill extends the missing participants program to defined contribution plans, defined benefit plans that have no more than 25 active participants and are maintained by professional service employers, and the portion of defined benefit plans that provide benefits based upon the separate accounts of participants and therefore are treated as defined contribution plans under ERISA.

Effective date.—The House bill is effective for distributions from terminating plans that occur after the PBGC has adopted final regulations implementing the House bill.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(b) Reduce PBGC premiums for small and new plans (secs. 702–703 of the House bill, secs. 682–683 of the Senate amendment, and sec. 4006 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides insurance protection for participants and beneficiaries under certain defined benefit pension plans by guaranteeing certain basic benefits under the plan in the event the plan is terminated with insufficient assets to pay benefits promised under the plan. The guaranteed benefits are funded in part by premium payments from employers who sponsor defined benefit plans. The amount of the required annual PBGC premium for a single-employer plan is generally a flat rate premium of $19 per participant and an additional variable-rate premium based on a charge of $9 per $1,000 of unfunded vested benefits. Unfunded vested benefits under a plan generally means (1) the unfunded current liability for vested benefits under the plan, over (2) the value of the plan's assets, reduced by any credit balance in the funding standard account. No variable-rate premium is imposed for a year if contributions to the plan were at least equal to the full funding limit.

The PBGC guarantee is phased in ratably in the case of plans that have been in effect for less than five years, and with respect to benefit increases from a plan amendment that was in effect for less than five years before termination of the plan.

HOUSE BILL

Reduced flat-rate premiums for new plans of small employers

Under the House bill, for the first five plan years of a new single-employer plan of a small employer, the flat-rate PBGC premium is $5 per plan participant.

A small employer is a contributing sponsor that, on the first day of the plan year, has 100 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

A new plan means a defined benefit plan maintained by a contributing sponsor if, during the 36-month period ending on the date of adoption of the plan, such contributing sponsor (or controlled group member or a predecessor of either) has not established or maintained a plan subject to PBGC coverage with respect to which benefits were accrued for substantially the same employees as are in the new plan.

Reduced variable-rate PBGC premium for new plans

The House bill provides that the variable-rate premium is phased in for new defined benefit plans over a six-year period starting with the plan's first plan year. The amount of the variable-rate premium is a percentage of the variable premium otherwise due, as follows: zero percent of the otherwise applicable variable-

rate premium in the first plan year; 20 percent in the second plan year; 40 percent in the third plan year; 60 percent in the fourth plan year; 80 percent in the fifth plan year; and 100 percent in the sixth plan year (and thereafter).

A new defined benefit plan is defined as described above under the flat-rate premium provision of the House bill relating to new small employer plans.

Reduced variable-rate PBGC premium for small plans

In the case of a plan of a small employer, the variable-rate premium is no more than $5 multiplied by the number of plan participants in the plan at the end of the preceding plan year. For purposes of the House bill, a small employer is a contributing sponsor that, on the first day of the plan year, has 25 or fewer employees. For this purpose, all employees of the members of the controlled group of the contributing sponsor are taken into account. In the case of a plan to which more than one unrelated contributing sponsor contributes, employees of all contributing sponsors (and their controlled group members) are taken into account in determining whether the plan is a plan of a small employer.

Effective date.—The reduction of the flat-rate premium for new plans of small employers and the reduction of the variable-rate premium for new plans is effective with respect to plans established after December 31, 2001. The reduction of the variable-rate premium for small plans is effective with respect to plan years beginning after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(c) Authorization for PBGC to pay interest on premium overpayment refunds (sec. 704 of the House bill, sec. 684 of the Senate amendment, and sec. 4007(b) of ERISA)

PRESENT LAW

The PBGC charges interest on underpayments of premiums, but is not authorized to pay interest on overpayments.

HOUSE BILL

The House bill allows the PBGC to pay interest on overpayments made by premium payors. Interest paid on overpayments is calculated at the same rate and in the same manner as interest is charged on premium underpayments.

Effective date.—The House bill is effective with respect to interest accruing for periods beginning not earlier than the date of enactment.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(d) Rules for substantial owner benefits in terminated plans (sec. 705 of the House bill, sec. 685 of the Senate amendment, and secs. 4021, 4022, 4043 and 4044 of ERISA)

PRESENT LAW

Under present law, the Pension Benefit Guaranty Corporation ("PBGC") provides participants and beneficiaries in a defined benefit pension plan with certain minimal guarantees as to the receipt of benefits under the plan in case of plan termination. The employer sponsoring the defined benefit pension plan is required to pay premiums to the PBGC to provide insurance for the guaranteed benefits. In general, the PBGC will guarantee all basic benefits which are payable in periodic installments for the life (or lives) of the participant and his or her beneficiaries and are non-forfeitable at the time of plan termination. The amount of the guaranteed benefit is subject to certain limitations. One limitation is that the plan (or an amendment to the plan which increases benefits) must be in effect for 60 months before termination for the PBGC to guarantee the full amount of basic benefits for a plan participant, other than a substantial owner. In the case of a substantial owner, the guaranteed basic benefit is phased in over 30 years beginning with participation in the plan. A substantial owner is one who owns, directly or indirectly, more than 10 percent of the voting stock of a corporation or all the stock of a corporation. Special rules restricting the amount of benefit guaranteed and the allocation of assets also apply to substantial owners.

HOUSE BILL

The House bill provides that the 60-month phase-in of guaranteed benefits applies to a substantial owner with less than 50 percent ownership interest. For a substantial owner with a 50 percent or more ownership interest ("majority owner"), the phase-in occurs over a 10-year period and depends on the number of years the plan has been in effect. The majority owner's guaranteed benefit is limited so that it could not be more than the amount phased in over 60 months for other participants. The rules regarding allocation of assets applies to substantial owners, other than majority owners, in the same manner as other participants.

Effective date.—The House bill is effective for plan terminations with respect to which notices of intent to terminate are provided, or for which proceedings for termination are instituted by the PBGC, after December 31, 2001.

SENATE AMENDMENT

The Senate amendment is the same as the House bill.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill or the Senate amendment.

(e) Civil penalties for breach of fiduciary responsibility (sec. 706 of the House bill and sec. 502 of ERISA)

PRESENT LAW

Present law requires the Secretary of Labor to assess a civil penalty against (1) a fiduciary who breaches a fiduciary responsibility under, or commits a violation of, part 4 of Title I of ERISA, or (2) any other person who knowingly participates in such a breach or violation. The penalty is equal to 20 percent of the "applicable recovery amount" that is paid pursuant to a settlement agreement with the Secretary of Labor or that a court orders to be paid in a judicial proceeding brought by the Secretary of Labor to enforce ERISA's fiduciary responsibility provisions. The Secretary of Labor may waive or reduce the penalty only if the Secretary finds in writing that either (1) the fiduciary or other person acted reasonably and in good faith, or (2) it is reasonable to expect that the fiduciary or other person cannot restore all the losses without severe financial hardship unless the waiver or reduction is granted.

HOUSE BILL

The House bill makes the assessment of the penalty discretionary with the Secretary of Labor, rather than mandatory. This change will allow the Secretary to refrain from imposing the penalty in certain cases as well as to assess a penalty of less than 20 percent of the applicable recovery amount. The requirement of a settlement agreement is also eliminated. The applicable recovery amount is any amount recovered by a plan or by a participant or beneficiary more than 30 days after the fiduciary's or other person's receipt of a written notice of the violation from the Department of Labor ("DOL"). Payments made after the 30-day grace period, whether they are made pursuant to a settlement agreement, or simply to discourage the DOL from bringing a legal action, are subject to the penalty, as are amounts recovered pursuant to a court order. ERISA section 502(l) is also amended to clarify that the term "applicable recovery amount" includes payments by third parties that are made on behalf of the relevant fiduciary or other persons liable for the amount that is recovered, including those who did not actually pay. These changes prevent avoidance of the penalty by having an unrelated third party pay the recovery amount.

Effective date.—The House bill applies to any breach of fiduciary responsibility or other violation of part 4 of Title I of ERISA occurring on or after the date of enactment. The change with respect to "applicable recovery amount" includes a transition rule whereby a breach or other violation occurring before the date of enactment which continues past the 180th day from enactment (and which may have been discontinued during that period) is treated as having occurred after the date of enactment (to avoid having to make a complex determination regarding how much of the applicable recovery amount for such continuing violations should be attributed to the post-enactment part of the violation).

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(f) Benefit suspension notice (sec. 707 of the House bill and sec. 203 of ERISA)

PRESENT LAW

Under present law (ERISA sec. 203(a)(3)(B)), a plan will not fail to satisfy the vesting requirements with respect to a participant by reason of suspending payment of the participant's benefits while such participant is employed. Under the applicable Department of Labor ("DOL") regulations, such a suspension is only permissible if the plan notifies the participant during the first calendar month or payroll period in which the plan withholds benefit payments. Such notice must provide certain information and must also include a copy of the plan's provisions relating to the suspension of payments.

In the case of a plan that does not pay benefits to active participants upon attainment of normal retirement age, the employer must monitor plan participants to determine when any participant who is still employed attains normal retirement age. In order to suspend payment of such a participant's benefits, generally a plan must, as noted above, promptly provide the participant with a suspension notice.

HOUSE BILL

The House bill directs the Secretary of Labor to revise the regulations relating to the benefit suspension notice to generally permit the information currently required to be set forth in a suspension notice to be included in the summary plan description. The House bill also directs the Secretary of Labor to eliminate the requirement that the notice include a copy of relevant plan provisions. However, individuals reentering the workforce to resume work with a former employer after they have begun to receive benefits will still receive the notification of the suspension of benefits (and a copy of the plan's provisions relating to suspension of payments). In addition, if a reduced rate of future benefit accruals will apply to a returning employee (as of his or her first date of participation in the plan after returning to work) who has begun to receive benefits, the notice must include a statement that the rate of future benefit accruals will be reduced.

Effective date.—The House bill applies to plan years beginning after December 31, 2001.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

(g) Studies (sec. 708 of the House bill)

PRESENT LAW

No provision.

HOUSE BILL

Study on small employer group plans

The House bill directs the Secretary of Labor, in consultation with the Secretary of the Treasury, to conduct a study to determine (1) the most appropriate form(s) of pension plans that would be simple to create and easy to maintain by multiple small employers, while providing ready portability of benefits for all participants and beneficiaries, (2) how such arrangements could be established by employer or employee associations, (3) how such arrangements could provide for employees to contribute independent of employer sponsorship, and (4) appropriate methods and strategies for making such pension plan coverage more widely available to American workers.

The Secretary of Labor is to consider the adequacy and availability of existing pension plans and the extent to which existing models may be modified to be more accessible to both employees and employers. The Secretary of Labor is to issue a report within 18 months, including recommendations for one or more model plans or arrangements as described above which may serve as the basis for appropriate administrative or legislative action.

Study on pension coverage

The House bill also directs the Secretary of Labor to report to the Committee on Education and the Workforce of the House of Representatives and the Committee on Health, Education, Labor and Pensions of the Senate regarding the effect of the bill on pension coverage, including: the extent of pension plan coverage for low and middle-income workers, the levels of pension plan benefits generally, the quality of pension plan coverage generally, worker's access to and participation in pension plans, and retirement security. This report is required to be submitted no later than five years after the date of enactment.

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

7. Miscellaneous provisions

(a) Tax treatment of electing Alaska Native Settlement Trusts (section 691 of the Senate amendment and new sections 646 and 6039H of the Code, modifying Code sections including 1(e), 301, 641, 651, 661, and 6034A))

PRESENT LAW

An Alaska Native Corporation ("ANC") may establish a Settlement Trust ("Trust") under section 39 of the Alaska Native Claims Settlement Act ("ANCSA")[136] and transfer money or other property to such Trust for the benefit of beneficiaries who constitute all or a class of the shareholders of the ANC, to promote the health, education and welfare of the beneficiaries and preserve the heritage and culture of Alaska Natives.

With certain exceptions, once an ANC has made a conveyance to a Trust, the assets conveyed shall not be subject to attachment, distraint, or sale or execution of judgment, except with respect to the lawful debts and obligations of the Trust.

The Internal Revenue Service ("IRS") has indicated that contributions to a Trust constitute distributions to the beneficiary-shareholders at the time of the contribution and are treated as dividends to the extent of earnings and profits as provided under section 301 of the Code.[137] Also, a Trust and its beneficiaries are generally taxed subject to applicable trust rules.[138]

Under general rules regarding the classification of entities, an entity that is taxed as a trust may not engage in business activity and must meet certain other requirements.[139] Under certain circumstances, a trust can be treated as a "grantor" trust rather than being taxed as a trust; and its income can be taxed directly to the person or persons considered the owner of the trust.[140]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment allows an election under which special rules will apply in determining the income tax treatment of an electing Trust and of its beneficiaries. An electing Trust will pay tax on its income at the lowest rate specified for ordinary income of an individual (or corresponding lower capital gains rate). The provision also specifies the treatment of distributions by an electing Trust to beneficiaries, the reporting requirements associated with such an election, and the consequences of disqualification for these benefits due to the allowance of certain impermissible dispositions of Trust interests, or of ANC stock.

Under the provision, a trust that is a Trust established by an Alaska Native Corporation under section 39 of ANCSA may make

[136] 43 U.S.C. 1601 et seq. A settlement Trust is subject to certain limitations under ANCSA, including that it may not operate a business. 43 U.S.C. 1629e(b).
[137] See, e.g., PLR 9824014; PLR 9433021; PLR 9329026 and PLR 9326019.
[138] See Subchapter J of the Code (secs. 641 et. seq.); Treas. Reg. Sec. 301.7701–4.
[139] Treas. Reg. Sec. 301.7701–4.
[140] Sec. 671 et. seq.

an election for its first taxable year ending after the date of enactment of the provision to be subject to the rules of the provision rather than otherwise applicable income tax rules. If the election is in effect, no amount will be included in the gross income of a beneficiary of such Trust by reason of a contribution to the Trust.[141] In addition, ordinary income of the electing Trust, whether accumulated or distributed, will be taxed only to the Trust (and not to beneficiaries) at the lowest individual tax rate for ordinary income. Capital gains of the electing Trust will similarly be taxed to the Trust at the capital gains rate applicable to individuals subject to such lowest rate. These rates will apply, rather than the higher rates generally applicable to trusts or to higher tax bracket beneficiaries. The election is made on a one-time basis only. The benefits of the election will terminate, however, and other special rules will apply, if the electing Trust or the sponsoring ANC fail to satisfy the restrictions on transferability of Trust beneficial interests or of ANC stock.

The treatment to beneficiaries of amounts distributed by an electing Trust depends upon the amount of the distribution. Solely for purposes of determining what amount has been distributed and thus which treatment applies under these rules, the amount of any distribution of property is the fair market value of the property at the time of the distribution.[142]

Amounts distributed by an electing Trust during any taxable year are excludable from the gross income of the recipient beneficiary to the extent of (1) the taxable income of the Trust for the taxable year and all prior taxable years for which an election was in effect (decreased by any income tax paid by the Trust with respect to the income) plus (2) any amounts excluded from gross income of the Trust under section 103 for those periods.[143]

If distributions to beneficiaries exceed the excludable amounts described above, then such excess distributions are reported and taxed to beneficiaries as if distributed by the ANC in the year of the distribution by the electing Trust to the extent the ANC then has current or accumulated earnings and profits, and are treated as dividends to beneficiaries.[144] Additional distributions in excess of the current or accumulated earnings and profits of the ANC are treated by the beneficiaries as distributions by the Trust in excess of the distributable net income of the Trust for such year.[145]

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[141] If the ANC transfers appreciated property to the Trust, section 311(b) of the Code will apply to the ANC, as under present law, so that the ANC will recognize gain as if it had sold the property for fair market value. The Trust takes the property with a fair market value basis, pursuant to section 301(d) of the Code.

[142] Section 661 of the Code, which provides a deduction to the trust for certain distributions, does not apply to an electing Trust under the provision unless the election is terminated by disqualification. Similarly, the inclusion provisions of section 662 of the Code, relating to amounts to be included in income of beneficiaries, also do not apply to a qualified electing Trust.

[143] In the case of any such excludable distribution that involves a distribution of property other than cash, the basis of such property in the hands of the recipient beneficiary will generally be the adjusted basis of the property in the hands of the Trust, unless the Trust makes an election to pay tax, in which case the basis in the hands of the beneficiary would be the fair market value of the property. See Code sections 643(e) and 643(e)(3).

[144] The treatment of such amounts distributed by an electing Trust as a dividend applies even if all or any part of the contributions by an ANC to a Trust would not have been dividends at the time of the contribution under present law; for example, because the ANC had no current or accumulated earnings and profits, or because the contribution was made from Alaska Native Fund amounts that may not have been taxable. See 43 U.S.C. 1605.

[145] Such distributions would not be taxable to the beneficiaries. In the case of any such nontaxable distribution that involves a distribution of property other than cash, the basis of such

The fiduciary of an electing Trust must report to the IRS, with the Trust tax return, the amount of distributions to each beneficiary, and the tax treatment to the beneficiary of such distributions under the provision (either as exempt from tax to the beneficiary, or as a distribution deemed made by the ANC). The electing Trust must also furnish such information to the ANC. In the case of distributions that are treated as if made by the ANC, the ANC must then report such amounts to the beneficiaries and must indicate whether they are dividends or not, in accordance with the earnings and profits of the ANC. The reporting thus required by an electing Trust will be in lieu of, and will satisfy, the reporting requirements of section 6034A (and such other reporting requirements as the Secretary of the Treasury may deem appropriate).

The earnings and profits of an ANC will not be reduced by the amount of its contributions to an electing Trust at the time of the contributions. However, the ANC earnings and profits will be reduced as and when distributions are thereafter made by the electing Trust that are taxed to beneficiaries under the provision as dividends from the ANC to the Trust beneficiaries.

If in any taxable year the beneficial interests in the electing Trust may be disposed of to a person in a manner that would not be permitted under ANCSA if the interests were Settlement Common Stock (generally, to a person other than an Alaska Native),[146] then the special provisions applicable to electing Trusts, including the favorable ordinary income tax rate and corresponding lower capital gains tax rate, cease to apply as of the beginning of such taxable year. The distributable net income of the Trust is increased up to the amount of current and accumulated earnings and profits of the ANC as of the end of that year, but such increase shall not exceed the fair market value of the assets of the Trust as of the date the beneficial interests of the Trust became disposable.[147] Thereafter, the Trust and its beneficiaries are generally subject to the rules of subchapter J and to the generally applicable trust income tax rates. Thus, the increase in distributable net income will result in the Trust being taxed at regular trust rates to the extent the recomputed distributable net income is not distributed to beneficiaries; and beneficiaries will be taxed to the extent there are distributions. Normal reporting rules applicable to trusts and their beneficiaries will apply. The basis of any property distributed to beneficiaries will also be determined under normal trust rules. The same rules apply if any stock of the ANC may be disposed of to a person in a manner that would not be permitted under ANCSA if the stock were Settlement Common Stock and the ANC makes a transfer to the Trust.

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property in the hands of the recipient beneficiary will generally be the adjusted basis of the property in the hands of the Trust, unless the Trust makes an election to pay tax, in which case the basis in the hands of the beneficiary will be the fair market value of the property. See Code sections 643(e) and 643(e)(3).

[146] Under ANSCA, Settlement Common Stock is subject to restrictions on transferability, generally limiting transfers. However, if changes are made to permit transfers of stock that would not be permitted for Settlement Common Stock, then the Settlement Common Stock is cancelled and Replacement Common Stock is issued. See 43 U.S.C. 1602(p), 1606(h) and 1629c.

[147] To the extent the earnings and profits of the ANC increase distributable net income of the Trust under this provision, the ANC will have a corresponding adjustment reducing its earnings and profits.

The provision contains a special loss disallowance rule that reduces any loss that would otherwise be recognized by a shareholder upon the disposition of a share of stock of a sponsoring ANC by a "per share loss adjustment factor". This factor reflects the aggregate of all contributions to an electing Trust sponsored by such ANC made on or after the first day the trust is treated as an electing Trust, expressed on a per share basis and determined as of the day of each such contribution.

The special loss disallowance rule is intended to prevent the allowance of noneconomic losses if the ANC stock owned by beneficiaries ever becomes transferable in any type of transaction that could cause the recognition of taxable gain or loss, (including a redemption by the ANC) where the basis of the stock in the hands of the beneficiary (or in the hands of any transferee of a beneficiary) fails to reflect the allocable reduction in corporate value attributable to amounts transferred by the ANC into the Trust.

Effective date.—The provision is effective for taxable years of Trusts, their beneficiaries, and sponsoring Alaska Native Corporations ending after the date of enactment, and to contributions made to electing Trusts during such year and thereafter.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

The conferees wish to state certain technical clarifications of the description of the Senate amendment, which also apply under the conference agreement.

Under the Senate amendment and the conference agreement, a Trust that makes the election remains subject to the generally applicable requirements for classification and taxation as a trust, in order to obtain the benefits of the provision.

Under the Senate amendment and the conference agreement, the per share loss adjustment factor for stock of an ANC is the aggregate of all contributions to all electing Trusts sponsored by such ANC made on or after the first day each such Trust is treated as an electing Trust expressed on a per share basis and determined as of the day of each such contribution.

Under the Senate amendment and the conference agreement, the restrictions on transfer of stock or beneficial interests under the provision are those that would apply to Settlement Common Stock under section 7(h) of ANSCA[148] (whether or not the interest or stock in question is in fact Settlement Common Stock). To the extent section 7(h) of ANSCA permits certain transfers of Settlement Common stock on death or in other special circumstances, those are also permitted under the provision. Also, the mere transferability of ANC stock in manner that would not be permitted for Settlement Common Stock (but without such transferability of any Trust interests) will not destroy the beneficial treatment of an existing electing Trust unless and until the ANC thereafter makes a transfer to the Trust.

Under the Senate amendment and the conference agreement, the surrender of an interest in an ANC or an electing Trust in order to accomplish the whole or partial redemption of the interest

[148] 43 U.S.C. 1606(h).

of a shareholder or beneficiary in such ANC or Trust, or to accomplish the whole or partial liquidation of such ANC or Trust, is deemed to be a transfer permitted by section 7(h) of ANSCA for purposes of the provision.

The conferees also wish to clarify the effect of the general sunset rule of the legislation on this provision. The general sunset is effective for taxable years beginning after December 31, 2010. For such taxable years, the tax consequences of any election previously made under this provision, and any right to make a future election, shall be terminated. Thus, for taxable years beginning after December 31, 2010, any electing Trust then in existence, its beneficiaries, and the sponsoring ANC shall be taxed under the provisions of law in effect immediately prior to the enactment of this provision.

8. Provisions relating to plan amendments (sec. 801 of the House bill)

PRESENT LAW

Plan amendments to reflect amendments to the law generally must be made by the time prescribed by law for filing the income tax return of the employer for the employer's taxable year in which the change in law occurs.

HOUSE BILL

The House bill permits certain plan amendments made pursuant to the changes made by the bill (or regulations issued under the provisions of the House bill) to be retroactively effective. If the plan amendment meets the requirements of the bill, then the plan is treated as being operated in accordance with its terms and the amendment does not violate the prohibition of reductions of accrued benefits. In order for this treatment to apply, the plan amendment must be made on or before the last day of the first plan year beginning on or after January 1, 2004 (January 1, 2006, in the case of a governmental plan). If the amendment is required to be made to retain qualified status as a result of the changes in the bill (or regulations) the amendment must be made retroactively effective as of the date on which the change became effective with respect to the plan and the plan must be operated in compliance until the amendment is made. Amendments that are not required to retain qualified status but that are made pursuant to the changes made by the bill (or applicable regulations) may be made retroactive as of the first day the plan was operated in accordance with the amendment.

A plan amendment is not considered to be pursuant to the bill (or applicable regulations) if it has an effective date before the effective date of the provision of the House bill (or regulations) to which it relates. Similarly, the House bill does not provide relief from section 411(d)(6) for periods prior to the effective date of the relevant provision of the House bill (or regulations) or the plan amendment.

The Secretary is authorized to provide exceptions to the relief from the prohibition on reductions in accrued benefits. It is intended that the Secretary will not permit inappropriate reductions in contributions or benefits that are not directly related to the pro-

visions of the House bill. For example, it is intended that a plan that incorporates the section 415 limits by reference could be retroactively amended to impose the section 415 limits in effect before the bill. On the other hand, suppose a plan that incorporates the section 401(a)(17) limit on compensation by reference provides for an employer contribution of three percent of compensation. It is expected that the Secretary will provide that the plan could not be amended retroactively to reduce the contribution percentage for those participants not affected by the section 401(a)(17) limit, even though the reduction will result in the same dollar level of contributions for some participants because of the increase in compensation taken into account under the plan. As another example, suppose that under present law a plan is top-heavy and therefore a minimum benefit is required under the plan, and that under the provisions of the House bill, the plan would not be considered to be top heavy. It is expected that the Secretary will generally permit plans to be retroactively amended to reflect the new top-heavy provisions of the House bill.

Effective date.—The House bill is effective on the date of enactment.

SENATE AMENDMENT

No provision.

CONFERENCE AGREEMENT

The conference agreement does not include the House bill.

VII. ALTERNATIVE MINIMUM TAX

A. Individual Alternative Minimum Tax Relief (Sec. 3(c) of H.R. 6, Sec. 701 of the Senate amendment and Sec. 55 of the Code)

PRESENT LAW

Present law imposes an alternative minimum tax ("AMT") on individuals to the extent that the tentative minimum tax exceeds the regular tax. An individual's tentative minimum tax generally is an amount equal to the sum of (1) 26 percent of the first $175,000 ($87,500 in the case of a married individual filing a separate return) of alternative minimum taxable income ("AMTI") in excess of an exemption amount and (2) 28 percent of the remaining AMTI. AMTI is the individual's taxable income adjusted to take account of specified preferences and adjustments.

The AMT exemption amounts are: (1) $45,000 in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 in the case of other unmarried individuals; and (3) $22,500 in the case of married individuals filing a separate return, estates and trusts. The exemption amounts are 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. The exemption

amounts, the threshold phase-out amounts, and rate brackets are not indexed for inflation.

HOUSE BILL

No provision.

However, H.R. 6, as passed by the House, increases the AMT exemption amount for married couples filing a joint return and surviving spouses by $1,000 in 2005, by an additional $500 in 2006, and by an additional $500 every even-numbered year thereafter. The exemption amount for married individuals filing a separate return is one-half the exemption amount for a married couple filing a joint return.

Effective date.—The provision applies to taxable years beginning after December 31, 2004.

SENATE AMENDMENT

The Senate amendment increases the AMT exemption amount for married couples filing a joint return and surviving spouses by $4,000. The AMT exemption amounts for other individuals (i.e., unmarried individuals and married individuals filing a separate return) are increased by $2,000.

Effective date.—The provision applies to taxable years beginning after December 31, 2000, and before January 1, 2007.

CONFERENCE AGREEMENT

The conference agreement increases the AMT exemption amount for married couples filing a joint return and surviving spouses by $4,000. The AMT exemption amounts for other individuals (i.e., unmarried individuals and married individuals filing a separate return) are increased by $2,000.

Effective date.—The provision applies to taxable years beginning after December 31, 2000, and beginning before January 1, 2005.

VIII. OTHER PROVISIONS

A. Modification to Corporate Estimated Tax Requirements (Secs. 801 and 815 of the Senate Amendment)

PRESENT LAW

In general, corporations are required to make quarterly estimated tax payments of their income tax liability (section 6655). For a corporation whose taxable year is a calendar year, these estimated tax payments must be made by April 15, June 15, September 15, and December 15.

HOUSE BILL

No provision.

SENATE AMENDMENT

With respect to corporate estimated tax payments due on September 17, 2001,[149] 30 percent is required to be paid by September 17, 2001, and 70 percent is required to be paid by October 1, 2001. With respect to corporate estimated tax payments due on September 15, 2004, 80 percent is required to be paid by September 15, 2004, and 20 percent is required to be paid by October 1, 2004.

With respect to corporate estimated tax payments due in July, August, or September 2011, the payment must be 170 percent of the amount otherwise required to be paid under the corporate estimated tax rules.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment with respect to corporate estimated tax payments due on September 15, 2004. With respect to corporate estimated tax payments due on September 17, 2001, 100 percent is not due until October 1, 2001. The conference agreement does not include the provision affecting corporate estimated tax payments due in 2011.

B. Authority To Postpone Certain Tax-Related Deadlines by Reason of Presidentially Declared Disaster (Sec. 802 of the Senate Amendment and Sec. 7508A of the Code)

PRESENT LAW

The Secretary of the Treasury may specify that certain deadlines are postponed for a period of up to 90 days in the case of a taxpayer determined to be affected by a Presidentially declared disaster.[150] The deadlines that may be postponed are the same as are postponed by reason of service in a combat zone. If the Secretary extends the period of time for filing income tax returns and for paying income tax, the Secretary must abate related interest for that same period of time.[151]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment directs the Secretary to create in the IRS a Permanent Disaster Response Team, which, in coordination with the Federal Emergency Management Agency, is to assist taxpayers in clarifying and resolving tax matters associated with a Presidentially declared disaster. One of the duties of the Disaster Response Team is to postpone certain tax-related deadlines for up to 120 days in appropriate cases for taxpayers determined to be affected by a Presidentially declared disaster.

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[149] September 15, 2001 will be a Saturday. Under present law, payments required to be made on a Saturday must be made no later than the next banking day.

[150] Section 7508A.

[151] Section 6404(h).

It is anticipated that the Disaster Response Team would be staffed by IRS employees with relevant knowledge and experience. It is anticipated that the Disaster Response Team would staff a toll-free number dedicated to responding to taxpayers affected by a Presidentially declared disaster and provide relevant information via the IRS website.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement expands the period of time with respect to which the Secretary may postpone certain deadlines from 90 days to 120 days. The conference agreement does not include the provision of the Senate amendment that provides for a Permanent Disaster Response Team.

C. Income Tax Treatment of Certain Restitution Payments to Holocaust Victims (Sec. 803 of the Senate amendment)

PRESENT LAW

Under the Code, gross income means "income from whatever source derived" except for certain items specifically exempt or excluded by statute (sec. 61). There is no explicit statutory exception from gross income provided for amounts received by Holocaust victims or their heirs.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that excludable restitution payments made to an eligible individual (or the individual's heirs or estate) are: (1) excluded from gross income; and (2) not taken into account for any provision of the Code which takes into account excludable gross income in computing adjusted gross income (e.g., taxation of Social Security benefits).

The basis of any property received by an eligible individual (or the individual's heirs or estate) that is excluded under this provision is the fair market value of such property at the time of receipt by the eligible individual (or the individual's heirs or estate).

The Senate amendment provides that any excludible restitution payment is disregarded in determining eligibility for, and the amount of benefits and services to be provided under, any Federal or federally assisted program which provides benefit or service based, in whole or in part, on need. Under the Senate amendment, no officer, agency, or instrumentality of any government may attempt to recover the value of excessive benefits or services provided under such a program before January 1, 2000, by reason of failure to take account of excludable restitution payments received before that date. Similarly, the Senate amendment requires a good faith effort to notify any eligible individual who may have been denied such benefits or services of their potential eligibility for such benefits or services. The Senate amendment also provides coordination

between this bill and Public Law 103–286, which also disregarded certain restitution payments in determining eligibility for, and the amount of certain needs-based benefits and services.

Eligible restitution payments are any payment or distribution made to an eligible individual (or the individual's heirs or estate) which: (1) is payable by reason of the individual's status as an eligible individual (including any amount payable by any foreign country, the United States, or any foreign or domestic entity or fund established by any such country or entity, any amount payable as a result of a final resolution of legal action, and any amount payable under a law providing for payments or restitution of property); (2) constitutes the direct or indirect return of, or compensation or reparation for, assets stolen or hidden, or otherwise lost to, the individual before, during, or immediately after World War II by reason of the individual's status as an eligible individual (including any proceeds of insurance under policies issued on eligible individuals by European insurance companies immediately before and during World War II); or (3) interest payable as part of any payment or distribution described in (1) or (2), above. An eligible individual is a person who was persecuted for racial or religious reasons by Nazi Germany, or any other Axis regime, or any other Nazi-controlled or Nazi-allied country.

Effective date.—The provision is effective for any amounts received on or after January 1, 2000. No inference is intended with respect to the income tax treatment of any amount received before January 1, 2000.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, with three changes. First, the definition of eligible individuals is expanded to also include individuals persecuted on the basis of physical or mental disability or sexual orientation. Second, interest earned by enumerated escrow or settlement funds are also excluded from tax. Third, the provision disregarding excludible restitution in determining eligibility for and the benefit calculation of certain Federal or Federally assisted programs is deleted.

D. Treatment of Survivor Annuity Payments with Respect to Public Safety Officers (Sec. 804 of the Senate amendment)

PRESENT LAW

The Taxpayer Relief Act of 1997 provided that an amount paid as a survivor annuity on account of the death of a public safety officer who is killed in the line of duty is excludable from income to the extent the survivor annuity is attributable to the officer's service as a law enforcement officer. The survivor annuity must be provided under a governmental plan to the surviving spouse (or former spouse) of the public safety officer or to a child of the officer.

The provision does not apply with respect to the death of a public safety officer if it is determined by the appropriate supervising authority that (1) the death was caused by the intentional misconduct of the officer or by the officer's intention to bring about the death, (2) the officer was voluntarily intoxicated at the time of death, (3) the officer was performing his or her duties in a grossly

negligent manner at the time of death, or (4) the actions of the individual to whom payment is to be made were a substantial contributing factor to the death of the officer.

For purposes of the exclusion, "public safety officer" is defined as in section 1204 of the Omnibus Crime Control and Safe Streets Act of 1968 (as amended). Under that Act, a public safety officer is an: (1) individual serving a public agency (with or without compensation) as a law enforcement officer, firefighter, rescue squad member, or ambulance crew member; (2) employee of the Federal Emergency Management Agency (FEMA) performing hazardous duties with respect to a Federally declared disaster area; and (3) employee of a State, local, or tribal emergency agency who is performing hazardous duties in cooperation with FEMA in a Federally declared disaster area.

The provision applies to amounts received in taxable years beginning after December 31, 1996, with respect to individuals dying after that date.

HOUSE BILL

No provision. However, H.R. 1727, the "Fallen Hero Survivor Benefit Fairness Act of 2001," as passed by the House, extends the present-law treatment of survivor annuities with respect to public safety officers killed in the line of duty with respect to individuals dying on or before December 31, 1996.

Effective date.—The provision is effective with respect to payments received after December 31, 2001.

SENATE AMENDMENT

The Senate amendment provision is the same as H.R. 1727.

Effective date.—The provision is effective with respect to payments received after December 31, 2000.

CONFERENCE AGREEMENT

The conference agreement does not include the provisions of H.R. 1727 or the Senate amendment provision.

E. Circuit Breaker (Sec. 805 of the Senate Amendment)

PRESENT LAW

The Congressional Budget Act of 1974 contains numerous rules enforcing the scope of items permitted to be considered under the budget reconciliation process.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that, in any fiscal year beginning with fiscal year 2004, if the level of debt held by the public at the end of that fiscal year (as projected by the Office of Management and Budget sequestration update report on August 20th preceding the beginning of that fiscal year) would exceed the level of debt held by the public for that fiscal year set forth in the concur-

rent resolution on the budget for fiscal year 2002, any Member of Congress may move to proceed to a bill that would make changes in law to reduce discretionary spending and direct pending (except for changes in Social Security, Medicare and COLA's) and increase revenues in a manner that would reduce the debt held by the public for the fiscal year to a level not exceeding the level provided in that concurrent resolution for that fiscal year.

A bill considered pursuant to this provision would be considered as provided in section 310(e) of the Congressional Budget Act.

The Senate amendment provides that it shall not be in order in the Senate to consider any bill, joint resolution, motion, amendment, or conference report pursuant to the provision that contains any provisions other than those enumerated in sections 310(a)(1) and 310(a)(2) of the Congressional Budget Act. This point of order may be waived or suspended in the Senate only by the affirmative vote of three-fifths of the Members. An affirmative vote of three-fifths of the Members shall be required in the Senate to sustain an appeal of the ruling of the Chair on a point of order raised pursuant to the provision.

Effective date.—The provision is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

F. Acceleration of Health Insurance Deduction for Self-Employed Individuals (Secs. 806 and 807 of the Senate Amendment and Sec. 162(l) of the Code)

PRESENT LAW

Under present law, the individual income tax treatment of health insurance expenses depends on the individual's circumstances. Self-employed individuals may deduct a portion of health insurance expenses for the individual and his or her spouse and dependents. The deductible percentage of health insurance expenses of a self-employed individual is 60 percent in 2001, 70 percent in 2002, and 100 percent in 2003 and thereafter. The deduction for health insurance expenses of self-employed individuals is not available for any month in which the individual is eligible to participate in a subsidized health plan maintained by the employer of the individual or the individual's spouse. The self-employed health deduction also applies to qualified long-term care insurance premiums treated as medical care for purposes of the itemized deduction for medical expenses, described below.

Employees can exclude from income 100 percent of employer-provided health insurance.

Individuals who itemize deductions may deduct their health insurance expenses only to the extent that the total medical expenses of the individual exceed 7.5 percent of adjusted gross income (sec. 213). Subject to certain dollar limitations, premiums for qualified long-term care insurance are treated as medical expenses for purposes of the itemized deduction for medical expenses (sec. 213). The amount of qualified long-term care insurance premiums that may

be taken into account for 2001 is as follows: $230 in the case of an individual 40 years old or less; $430 in the case of an individual who is over 40 but not more than 50; $860 in the case of an individual who is more than 50 but not more than 60; $2,290 in the case of an individual who is more than 60 but not more than 70; and $2,860 in the case of an individual who is more than 70. These dollar limits are indexed for inflation.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment increases the deduction for health insurance expenses (and qualified long-term care insurance expenses) of self-employed individuals to 100 percent beginning in 2002. The Senate amendment also provides that the deduction is not available for any month in which the self-employed individual participates in (rather than is eligible for) a subsidized health plan maintained by ay employer of the individual or his or her spouse.

Effective date.—The provision is effective for taxable years beginning after December 31, 2001.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

G. Enhanced Deduction for Charitable Contribution of Literary, Musical, and Artistic Compositions (Sec. 808 of the Senate Amendment and Sec. 170 of the Code)

PRESENT LAW

In the case of a charitable contribution of inventory or other ordinary-income or short-term capital gain property, the amount of the deduction is limited to the taxpayer's basis in the property. In the case of a charitable contribution of tangible personal property, the deduction is limited to the taxpayer's basis in such property if the use by the recipient charitable organization is unrelated to the organization's tax-exempt purpose. In cases involving contributions to a private foundation (other than certain private operating foundations), the amount of the deduction is limited to the taxpayer's basis in the property.

Under present law, charitable contributions of literary, musical, and artistic compositions are considered ordinary income property and a taxpayer's deduction of such property is limited to the taxpayer's basis (typically, cost) in the property. To be eligible for the deduction, the contribution must be of an undivided portion of the donor's entire interest in the property. For purposes of the charitable income tax deduction, the copyright and the work in which the copyright is embodied are not treated as separate property interests. Accordingly, if a donor owns a work of art and the copyright to the work of art, a gift of the artwork without the copyright or the copyright without the artwork will constitute a gift of

a "partial interest" and will not qualify for the income tax charitable deduction.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that a deduction for qualified artistic charitable contributions is the fair market value of the property contributed at the time of the contribution. The Senate amendment defines a qualified artistic charitable contribution to mean a charitable contribution of any literary, musical, artistic, or scholarly composition, or similar property, or the copyright thereon (or both). The tangible property and the copyright on such property are treated as separate interests in the property for purposes of the "partial interest" rule. Contributions of letters, memoranda, or similar property that are written, prepared, or produced by or for an individual in his or her capacity as an officer or employee of any person (including a government agency or instrumentality) do not qualify for fair market value deduction unless the contributed property is entirely personal.

Under the Senate amendment, the increase in the deduction that results from the provision cannot exceed the amount of adjusted gross income of the donor for the taxable year from the sale or use of property created by the donor that is of the same type as the donated property, and from teaching, lecturing, performing, or similar activities with respect to such property. The fair market value deduction cannot be carried over and deducted in other taxable years.

A contribution is required to meet several requirements in order to qualify for the fair market value deduction. First, the contributed property must have been created by the personal efforts of the donor at least 18 months prior to the date of contribution. Second, the donor must obtain a qualified appraisal of the contributed property, a copy of which must be attached to the donor's income tax return for the taxable year in which such contribution is made. Third, the contribution must be made to a public charity or to certain limited types of private foundations. Finally, the use of donated property by the recipient organization must be related to the organization's charitable purpose or function, and the donor must receive a written statement from the organization verifying such use.

Effective date.—The deduction for qualified artistic charitable contributions applies to contributions made after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

H. Estate Tax Recapture From Cash Rents of Specially-Valued Property (Sec. 809 of the Senate Amendment)

PRESENT LAW

Under the special-use valuation rules of section 2032A, the executor may elect to value certain "qualified real property" used in farming or another qualifying trade or business at its current use rather than its highest and best use. If, after the special-use valuation election is made, the heir who acquired the real property ceases to use it in its qualified use within 10 years (15 years for individuals dying before 1982) of the decedent's death, an additional estate tax is imposed in order to "recapture" the benefit of the special-use valuation. Section 2032A is effective for estates of decedents dying after December 31, 1976.

Under prior law, some courts had held that cash rental of property for which special-use valuation was claimed was not a qualified use under the rules, because the heirs no longer bore the financial risk of working the property, thus triggering the additional estate tax.[152]

With respect to a decedent's surviving spouse, a special rule provides that the surviving spouse will not be treated as failing to use the property in a qualified use solely because the spouse rents the property to a member of the spouse's family on a net cash basis. Members of an individual's family include (1) the individual's spouse, (2) the individual's ancestors, (3) lineal descendants of the individual, of the individual's spouse, or of the individual's parents, and (4) the spouses of any such lineal descendants.

Section 504(c) of the Tax Reform Act of 1997 expanded the class of heirs eligible to lease property for which special-use valuation was claimed without causing the qualified use of such property to cease for purposes of imposition of the additional estate tax. Section 2032A(c)(7)(E) provides that the net cash lease of property (for which special-use valuation was claimed) by a lineal descendant of the decedent to a member of such lineal descendant's family does not cause the qualified use of the property to cease for purposes of imposition of the additional estate tax. The amendment made under the Tax Reform Act of 1997 applies to leases entered into after December 31, 1976.

In Technical Advice Memorandum 9843001, the IRS determined that the retroactive effective date in the changes made by the Tax Reform Act of 1997 did not constitute a waiver of the period of limitations otherwise applicable on a taxpayer's claim. Accordingly, the IRS determined that a taxpayer's claim for refund of recapture tax paid on account of the cessation of a qualified use was barred under the generally applicable statute of limitations on refund claims.

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[152] See *Martin* v. *Commissioner,* 783 F.2d 81 (7th Cir. 1986) (cash lease to unrelated party not qualified use); *Williamson* v. *Commissioner,* 93 T.C. 242 (1989), *aff'd.* 974 F.2d 1525 (9th Cir. 1992) (cash lease to family member not a qualified use); *Fisher* v. *Commissioner,* T.C. Memo. 1993–139 (cash lease to family member not a qualified use); *cf. Minter* v. *U.S.,* 19 F.3d 426 (8th Cir. 1994) (cash lease to family's farming corporation is qualified use); *Estate of Gavin* v. *U.S.,* 103 F.3d 802 (8th Cir. 1997) (heir's option to pay cash rent or 50 percent crop share is qualified use).

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that, if on the date of enactment or at any time within one year after the date of enactment, a claim for refund or credit of any overpayment of tax resulting from the application of net cash lease provisions for spouses and lineal descendants (Sec. 2032A(c)(7)(E)) is barred by operation of law or rule of law, then the refund or credit of such overpayment shall, nonetheless, be allowed if a claim therefore is filed before the date that is one year after the date of enactment.

Effective date.—This provision is effective for refund claims filed prior to the date that is one year after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment.

I. Extension of Research and Experimentation Tax Credit and New Vaccine Research Credit (Secs. 810 and 811 of the Senate Amendment and Sec. 41 and New Sec. 45G of the Code)

PRESENT LAW

Section 41 provides for a research tax credit equal to 20 percent of the amount by which a taxpayer's qualified research expenditures for a taxable year exceeded its base amount for that year. The research tax credit generally applies to amounts paid or incurred before July 1, 2004.

Except for certain university basic research payments made by corporations, the research tax credit applies only to the extent that the taxpayer's qualified research expenditures for the current taxable year exceed its base amount. The base amount for the current year generally is computed by multiplying the taxpayer's "fixed-base percentage" by the average amount of the taxpayer's gross receipts for the four preceding years. If a taxpayer both incurred qualified research expenditures and had gross receipts during each of at least three years from 1984 through 1988, then its "fixed-base percentage" is the ratio that its total qualified research expenditures for the 1984–1988 period bears to its total gross receipts for that period (subject to a maximum ratio of 0.16). All other taxpayers (so-called "start-up firms") are assigned a fixed-base percentage of 3.0 percent.

Taxpayers are allowed to elect an alternative incremental research credit regime. If a taxpayer elects to be subject to this alternative regime, the taxpayer is assigned a three-tiered fixed-base percentage (that is lower than the fixed-base percentage otherwise applicable under present law) and the credit rate likewise is reduced. Under the alternative credit regime, a credit rate of 2.65 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.0 percent (i.e., the base amount equals 1.0 percent of the taxpayer's average gross receipts for the four preceding

years) but do not exceed a base amount computed by using a fixed-base percentage of 1.5 percent. A credit rate of 3.2 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 1.5 percent but do not exceed a base amount computed by using a fixed-base percentage of 2.0 percent. A credit rate of 3.75 percent applies to the extent that a taxpayer's current-year research expenses exceed a base amount computed by using a fixed-base percentage of 2.0 percent. An election to be subject to this alternative incremental credit regime may be made for any taxable year beginning after June 30, 1996, and such an election applies to that taxable year and all subsequent years (in the event that the credit subsequently is extended by Congress) unless revoked with the consent of the Secretary of the Treasury.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment would make the research credit permanent.

The Senate amendment also would increase the credit rates under the alternative incremental credit from 2.65 percent to 3.0 percent, from 3.2 percent to 4.0 percent, and from 3.75 percent to 5.0 percent.

In addition, the Senate amendment would provide a new research credit with respect to certain qualified vaccine and microbiocide research. The amendment would provide a credit equal to 30 percent of qualifying vaccine research expenses undertaken to develop vaccines and microbicides for malaria, tuberculosis, HIV, or any infectious disease (of a single etiology) which, according to the World Health Organization, causes over one million human deaths annually.[153] Qualifying expenses would include 100 percent of in-house research expenses and 100 percent of contract research expenses. In-house research expenses and contract research expenses would be defined as in present-law sec. 41. Qualifying vaccine research expenses would not include expenses for research incurred outside the United States, other than in the case of expenses for human clinical testing. No credit may be claimed for pre-clinical expenses unless a research plan has been filed with the Secretary of the Treasury.

Effective date.—The provision generally would be effective on the date of enactment. The increase in credit rates under the alternative incremental credit and the new credit for qualifying vaccine research expenses would be effective for taxable years ending after the date of enactment.

[153] The credit for vaccine research expenses would be coordinated with the credit for research under present-law sec. 41 and any deduction otherwise allowed with respect to qualifying vaccine research expenses would be reduced by the amount of the credit claimed for vaccine research expenses.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment.

J. Acceleration of Round II Empowerment Zone Wage Credit (Sec. 812 of the Senate Amendment and Sec. 1396 of the Code)

PRESENT LAW

The Omnibus Budget Reconciliation Act of 1993 ("OBRA 1993") authorized the designation of nine empowerment zones ("Round I empowerment zones") to provide tax incentives for businesses to locate within targeted areas designated by the Secretaries of Housing and Urban Development and Agriculture. The Taxpayer Relief Act of 1997 ("1997 Act") authorized the designation of two additional Round I urban empowerment zones. Among other incentives, Round I empowerment zones qualify for a 20-percent wage credit for the first $15,000 of wages paid to a zone resident who works in the empowerment zone.

The 1997 Act also authorized the designation of 20 additional empowerment zones ("Round II empowerment zones"), of which 15 are located in urban areas and five are located in rural areas. The 1997 Act did not authorize a wage credit for businesses located in the Round II empowerment zones. The Community Renewal Tax Relief Act of 2000, however, extended the 20-percent wage credit to Round II empowerment zones for wages paid or incurred after December 31, 2001.[154]

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment accelerates the availability of the wage credit for Round II empowerment zones to the earlier of July 1, 2001, or the date of enactment of the bill.

Effective date.—For wages paid or incurred after the earlier of July 1, 2001 or date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not contain the Senate amendment.

K. Treatment of Certain Hospital Support Organizations in Determining Acquisition Indebtedness (Sec. 813 of the Senate Amendment and Sec. 514 of the Code)

PRESENT LAW

In general, income of a tax-exempt organization that is produced by debt-financed property is treated as unrelated business

[154] H.R. 5662, sec. 113 (2000) (enacted by Pub. L. No. 106–554); sec. 1396(b). Among other changes, the Community Renewal Tax Relief Act of 2000 extended all empowerment zone designations through December 31, 2009, and provided that the wage credit rate remains at 20 percent for all empowerment zones (rather than being phased down) through December 31, 2009.

income in proportion to the acquisition indebtedness on the income-producing property. Acquisition indebtedness generally means the amount of unpaid indebtedness incurred by an organization to acquire or improve the property and indebtedness that would not have been incurred but for the acquisition or improvement of the property. However, under an exception, acquisition indebtedness does not include indebtedness incurred by certain qualified organizations to acquire or improve real property. Qualified organizations include pension trusts, educational institutions, and title-holding companies.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment expands the exception to the definition of acquisition indebtedness in the case of a qualified hospital support organization. The exception applies to eligible indebtedness (or the qualified refinancing thereof) of the qualified hospital support organization.

A qualified hospital support organization is a supporting organization (under Code section 509(a)(3)) of a hospital that is an academic health center (under Code section 119(d)(4)(B)). The assets of the supporting organization must also meet certain requirements. First, more than half of the value of its assets at any time since its organization (1) must have been acquired, directly or indirectly, by gift or devise, and (2) must consist of real property. In addition, the fair market value of the organization's real estate acquired by gift or devise must exceed 10 percent of the fair market value of all investment assets held by the organization immediately prior to the time that the eligible indebtedness is incurred. These requirements must be met each time eligible indebtedness is incurred or a qualified refinancing thereof occurs.

Eligible indebtedness means indebtedness secured by real property acquired by gift or devise, the proceeds of which are used exclusively to acquire a leasehold interest in or to improve the property. A qualified refinancing of eligible indebtedness occurs if the refinancing does not exceed the amount of refinanced eligible indebtedness immediately before the refinancing.

Effective date.—The Senate amendment applies to indebtedness incurred after December 31, 2003.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

L. Modify Rules Governing Tax-Exempt Bonds for Certain Private Water Facilities (Sec. 814 of the Senate Amendment and Sec. 142 of the Code)

PRESENT LAW

Interest on State or local government bonds is tax-exempt when the proceeds of the bonds are used to finance activities car-

ried out by or paid for by those governmental units. Interest on bonds issued by State or local governments acting as conduit borrowers for private businesses is taxable unless a specific exception is included in the Code. One such exemption allows tax-exempt bonds to be issued to finance privately owned and operated facilities for the furnishing of water. Such facilities must be operated in a manner similar to municipal water facilities in that service must be offered to the general public, and rates must be regulated. Tax-exempt private activity bonds for water facilities may be issued to finance arsenic and other pollutant treatment facilities.

Issuance of private activity tax-exempt bonds for water facilities is subject to aggregate annual State volume limitations that apply to most private activity bonds. Similarly, like most other private activity bonds, interest on these bonds is a preference item for purposes of the alternative minimum tax.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that private activity bonds for facilities to remediate arsenic levels in water (as opposed to such bonds to finance private water treatment facilities generally) are not subject to the State volume limits and the interest on the bonds is not a preference item for the alternative minimum tax. A bond is treated as for arsenic remediation if at least 95 percent of the proceeds are used for facilities to comply with the 10 parts per billion standard recommended by the National Academy of Sciences. The provision does not affect governmental bonds for municipal water facilities.

Effective date.—The provision is effective for bonds issued after the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

M. Combined Employment Tax Reporting (Sec. 816 of the Senate Amendment and Sec. 6103(d)(5) of the Code)

PRESENT LAW

The Internal Revenue Code prohibits disclosure of tax returns and return information, except to the extent specifically authorized by the Internal Revenue Code (sec. 6103). Unauthorized disclosure is a felony punishable by a fine not exceeding $5,000 or imprisonment of not more than five years, or both (sec. 7213). An action for civil damages also may be brought for unauthorized disclosure (sec. 7431). No tax information may be furnished by the Internal Revenue Service ("IRS") to another agency unless the other agency establishes procedures satisfactory to the IRS for safeguarding the tax information it receives (sec. 6103(p)).

The Taxpayer Relief Act of 1997 authorized a demonstration project to assess the feasibility and desirability of expanding com-

bined reporting. The demonstration project was: (1) limited to State of Montana, (2) limited to employment taxes, (3) limited to taxpayer identity (name, address, taxpayer identifying number) and the signature of the taxpayer and (4) limited to a period of five years. After August 5, 2002, the demonstration project will expire.

To implement that demonstration project, the Taxpayer Relief Act of 1997 amended the Code to authorize the IRS to disclose the name, address, taxpayer identifying number, and signature of the taxpayer, which is common to both the State and Federal portions of the combined form. The Code permits the IRS to disclose these common data items to the State and not have it subject to the redisclosure restrictions, safeguards, or criminal penalty provisions.[155] Essentially, the State is allowed to use this information as if the State directly received this information from the taxpayer.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment makes the IRS disclosure authority permanent and expands the authorized recipients to include any State agency, body, or commission, for the purpose of carrying out a combined Federal and State employment tax reporting program approved by the Secretary. The statutory waiver of the redisclosure restrictions, safeguards, and criminal penalty provisions continues to apply. Further, the items authorized for disclosure continue to be limited to the name, address, taxpayer identification number, and signature of the taxpayer.

Effective date.—The Senate amendment is effective on the date of enactment.

CONFERENCE AGREEMENT

The conference agreement does not contain the Senate amendment.

N. Reporting Requirements of State and Local Political Organizations (Secs. 901–904 of the Senate Amendment and Secs. 527 and 6012 of the Code)

PRESENT LAW

In general

Under present law, section 527 provides a limited tax-exempt status to "political organizations," meaning a party, committee, association, fund, account, or other organization (whether or not incorporated) organized and operated primarily for the purpose of directly or indirectly accepting contributions or making expenditures (or both) for an "exempt function." These organizations are generally exempt from Federal income tax on contributions they re-

[155] Sec. 6103(d)(5). The following restrictions and requirements do not apply: (1) the prohibition on disclosure of returns or return information by State officers and employees (sec. 6103(a)(2); (2) the Federal penalties for unauthorized disclosure and inspection of returns and return information (secs. 7213 and 7213A) and (3) the requirement that the State establish safeguards regarding the information obtained from the IRS (sec. 6103(p)(4)).

ceive, but are subject to tax on their net investment income and certain other income at the highest corporate income tax rate ("political organization taxable income"). Donors are exempt from gift tax on their contributions to such organizations. For purposes of section 527, the term "exempt function" means: the function of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any Federal, State, or local public office or office in a political organization, or the election of Presidential or Vice-Presidential electors, whether or not such individual or electors are selected, nominated, elected, or appointed. Thus, by definition, the purpose of a section 527 organization is to accept contributions or make expenditures for political campaign (and similar) activities.

Notice of section 527 organization

An organization is not treated as a section 527 organization unless it has given notice to the Secretary of the Treasury, electronically and in writing, that it is a section 527 organization. The notice is not required (1) of any person required to report as a political committee under the Federal Election Campaign Act of 1971, (2) by organizations that reasonably anticipate that their annual gross receipts will always be less than $25,000, and (3) organizations described in section 501(c). All other organizations, including State and local candidate committees, are required to file the notice.

The notice is required to be transmitted no later than 24 hours after the date on which the organization is organized. The notice is required to include the following information: (1) the name and address of the organization and its electronic mailing address, (2) the purpose of the organization, (3) the names and addresses of the organization's officers, highly compensated employees, contact person, custodian of records, and members of the organization's Board of Directors, (4) the name and address of, and relationship to, any related entities, and (5) such other information as the Secretary may require.

The notice of status as a section 527 organization is required to be disclosed to the public by the IRS and by the organization. In addition, the Secretary of the Treasury is required to make publicly available on the Internet and at the offices of the IRS a list of all political organizations that file a notice with the Secretary under section 527 and the name, address, electronic mailing address, custodian of records, and contact person for such organization. The IRS is required to make this information available within 5 business days after the Secretary of the Treasury receives a notice from a section 527 organization.

An organization that fails to file the notice is not treated as a section 527 organization and its exempt function income is taken into account in determining taxable income.

Disclosure by political organizations of expenditures and contributors

A political organization that accepts a contribution or makes an expenditure for an exempt function during any calendar year is required to file with the Secretary of the Treasury certain reports.

The following reports are required: either (1) in the case of a calendar year in which a regularly scheduled election is held, quarterly reports, a pre-election report, and a post-general election report and, in the case of any other calendar year, a report covering January 1 to June 30 and July 1 to December 31, or (2) monthly reports for the calendar year, except that, in lieu of the reports due for November and December of any year in which a regularly scheduled general election is held, a pre-general election report, a post-general election report, and a year end report are to be filed.

The reports are required to include the following information: (1) the amount of each expenditure made to a person if the aggregate amount of expenditures to such person during the calendar year equals or exceeds $500 and the name and address of the person (in the case of an individual, including the occupation and name of the employer of the individual); and (2) the name and address (in the case of an individual, including the occupation and name of employer of such individual) of all contributors that contributed an aggregate amount of $200 or more to the organization during the calendar year and the amount of the contribution.

The disclosure requirements do not apply (1) to any person required to report as a political committee under the Federal Election Campaign Act of 1971, (2) to any State or local committee of a political party or political committee of a State or local candidate, (3) to any organization that reasonably anticipates that it will not have gross receipts of $25,000 or more for any taxable year, (4) to any organization described in section 501(c), or (5) with respect to any expenditure that is an independent expenditure (as defined in section 301 of the Federal Election Campaign Act of 1971).

For purposes of the disclosure requirements, the term "election" means (1) a general, special, primary, or runoff election for a Federal office, (2) a convention or caucus of a political party that has authority to nominate a candidate for Federal office, (3) a primary election held for the selection of delegates to a national nominating convention of a political party, or (4) a primary election held for the expression of a preference for the nomination of individuals for election to the office of President.

The IRS is required to make available to the public any report filed by a political organization. In addition, the organization is required to make any such report available to the public. A penalty is imposed for failure to file a report or provide required information in the report.

Return requirements for section 527 organizations

Under present law, a section 527 organization that has political organization taxable income is required annually to file Form 1120–POL (Return of Organization Exempt from Income Tax). Section 527 organizations that do not have political organization taxable income but have gross receipts of $25,000 or more during the taxable year also are required to file an income tax return. The gross receipts requirement does not apply to political organizations that are subject to section 527 solely by reason of section 527(f)(1) (which makes certain charities subject to section 527 based on the charity's political activities). The annual return must be made available to the public by the organization and by the IRS.

HOUSE BILL

No provision.

SENATE AMENDMENT

The Senate amendment provides that a political organization that is a political committee of a State or local candidate is exempt from the requirement to provide notice to the Secretary of its formation and purpose.

In addition, the Senate amendment exempts certain political organizations from the requirement provided by section 527(j)(2) to file regular reports with the Secretary detailing contribution and expenditure information. To be exempt from such reporting requirements under the amendment: (1) the organization must not be an organization already exempt from the reporting requirement under present law (as provided by section 527(j)(5)); (2) the organization must not engage in any exempt function activities other than activities for the purpose of influencing or attempting to influence the selection, nomination, election, or appointment of any individual to any State or local public office or office in a State or local political organization; and (3) no candidate for Federal office or individual holding Federal office can control or materially participate in the direction of the organization, solicit any contributions to the organization, or direct, in whole or in part, any expenditure made by the organization. Further, during the calendar year, the organization must be required to report under State or local law, and must in fact report, information regarding each separate expenditure and contribution (including information regarding the person who makes such contribution or receives such expenditure) that otherwise would be required. The agency with which such information is filed must make the filed information public and available for public inspection. If the minimum amount of a contribution or expenditure that triggers disclosure under State or local law is more than $100 than the minimum amount for disclosure required by the Code, the requirements for exemption from reporting will not be met.

Under the Senate amendment, political organizations described in the preceding paragraph are exempt from the requirement to file an income tax return if such organization does not have political organization taxable income, is not subject to section 527 solely by reason of section 527(f)(1) (as described above), and has gross receipts of less than $100,000 for the taxable year.

The Senate amendment further provides that the Secretary in consultation with the Federal Election Commission shall publicize the effects of these changes and the interaction of the requirements to file a notification or report under section 527 and reports under the Federal Election Campaign Act of 1971.

Finally, the Senate amendment gives the Secretary the authority to waive all or any portion of the penalties imposed on an organization for failure to notify the Secretary of the organization's establishment or the failure to file a report. Such waiver is subject to a showing by the organization that the failure was due to reasonable cause and not to willful neglect.

Effective date.—The exemptions from the notification, reporting, and return requirements are effective as of July 1, 2000. The authority to the Secretary to waive penalties is effective for any tax assessed or penalty imposed after June 30, 2000.

CONFERENCE AGREEMENT

The conference agreement does not include the Senate amendment provision.

IX. COMPLIANCE WITH CONGRESSIONAL BUDGET ACT

(SECS. 111, 211, 311, 451, 581, 695, 711, AND 821 OF THE SENATE AMENDMENT)

PRESENT LAW

Reconciliation is a procedure under the Congressional Budget Act of 1974 (the "Budget Act") by which Congress implements spending and tax policies contained in a budget resolution. The Budget Act contains numerous rules enforcing the scope of items permitted to be considered under the budget reconciliation process. One such rule, the so-called "Byrd rule," was incorporated into the Budget Act in 1990. The Byrd rule, named after its principal sponsor, Senator Robert C. Byrd, is contained in section 313 of the Budget Act. The Byrd rule generally permits members to raise a point of order against extraneous provisions (those which are unrelated to the goals of the reconciliation process) from either a reconciliation bill or a conference report on such bill.

Under the Byrd rule, a provision is considered to be extraneous if it falls under one or more of the following six definitions:

(1) It does not produce a change in outlays or revenues;

(2) It produces an outlay increase or revenue decrease when the instructed committee is not in compliance with its instructions;

(3) It is outside of the jurisdiction of the committee that submitted the title or provision for inclusion in the reconciliation measure;

(4) It produces a change in outlays or revenues which is merely incidental to the nonbudgetary components of the provision;

(5) It would increase the deficit for a fiscal year beyond those covered by the reconciliation measure; and

(6) It recommends changes in Social Security.

HOUSE BILL

No provision.

SENATE AMENDMENT

Sunset of provisions

To ensure compliance with the Budget Act, the Senate amendment provides that all provisions of, and amendments made by, the bill that are in effect on September 30, 2011, shall cease to apply as of the close of September 30, 2011.

CONFERENCE AGREEMENT

The conference agreement follows the Senate amendment, except that all provisions of, and amendments made by, the bill generally do not apply for taxable, plan or limitation years beginning after December 31, 2010. With respect to the estate, gift, and generation-skipping provisions of the bill, the provisions do not apply to estates of decedents dying, gifts made, or generation skipping transfers, after December 31, 2010. The Code and the Employee Retirement Income Security Act of 1974 are applied to such years, estates, gifts and transfers after December 31, 2010, as if the provisions of and amendments made by the bill had never been enacted.

X. TAX COMPLEXITY ANALYSIS

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service ("IRS") and the Treasury Department) to provide a complexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and the Treasury Department regarding each of the provisions included in the complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

1. Reduction in income tax rates for individuals (sec. 101 of the conference agreement)

Summary description of provision

The bill creates a new 10-percent regular income tax bracket for a portion of the taxable income that is currently taxed at 15 percent. The bill reduces the other regular income tax rates. By 2006, the present-law individual income tax rates of 28 percent, 31 percent, 36 percent, and 39.6 percent are lowered to 25 percent, 28 percent, 33 percent, and 35 percent, respectively. The bill also provides for acceleration of the 10 percent income tax rate bracket benefit for 2001, principally through advance payment of the credit in the form of checks issued to taxpayers by the Department of the Treasury.

Number of affected taxpayers

It is estimated that the provision will affect approximately 100 million individual tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. It should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. It may, however, increase the number of questions that taxpayers ask the IRS, such as when taxpayers will receive their checks. This increased volume of questions could have an adverse impact on other elements of IRS' operations, such as the levels of taxpayer service. In addition, the provision should not increase the tax preparation costs for most individuals.

The IRS will need to add to the individual income tax forms package a new worksheet so that taxpayers can reconcile the amount of the check they receive from the Department of the Treasury with the credit they are allowed as an acceleration of the 10 percent income tax rate bracket benefit for 2001. This worksheet should be relatively simple and many taxpayers will not need to fill it out completely because they will have received the full amount by check.

The Secretary of the Treasury is expected to make appropriate revisions to the wage withholding tables to reflect the proposed rate reduction for calendar year 2001 as expeditiously as possible. To implement the effects of the rate cuts for 2001, employers would be required to use a new (second) set of withholding rate tables to determine the correct withholding amounts for each employee. Switching to the new withholding rate tables during the year can be expected to result in a one-time additional burden for employers (or additional costs for employers that rely on a bookkeeping or payroll service).

2. Standard deduction tax relief (sec. 301 of the conference agreement)

Summary description of provision

The bill increases the basic standard deduction for married taxpayers filing a joint return to twice the basic standard deduction for an unmarried individual. The increase is phased-in over five years beginning in 2005 and would be fully phased-in for 2009 and thereafter.

Number of affected taxpayers

It is estimated that the provision will affect approximately 23 million individual returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The higher basic standard deduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals' tax preparation costs.

Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. According to estimates by the staff of the Joint

Committee on Taxation, approximately three million individual tax returns will realize greater tax savings from the increased standard deduction than from itemizing their deductions. In addition to the tax savings, such taxpayers will no longer have to file Schedule A to Form 1040 and a significant number of which will no longer need to engage in the record keeping inherent in itemizing below-the-line deductions. Moreover, by claiming the standard deduction, such taxpayers may qualify to use simpler versions of the Form 1040 (i.e., Form 1040EZ or Form 1040A) that are not available to individuals who itemize their deductions. These forms simplify the return preparation process by eliminating from the Form 1040 those items that do not apply to particular taxpayers.

This reduction in complexity and record keeping also may result in a decline in the number of individuals using a tax preparation service or a decline in the cost of using such a service. Furthermore, if the provision results in a taxpayer qualifying to use one of the simpler versions of the Form 1040, the taxpayer may be eligible to file a paperless Federal tax return by telephone. The provision also should reduce the number of disputes between taxpayers and the IRS regarding substantiation of itemized deductions.

3. Expansion of the 15-percent rate bracket (sec. 302 of the conference agreement)

Summary description of provision

The provision increases the size of the 15-percent regular income tax rate bracket for married individuals filing a joint return to twice the size of the corresponding rate bracket for unmarried individuals. This increase is phased-in over four years beginning in 2005. It is fully effective beginning in 2008.

Number of affected taxpayers

It is estimated that the provision will affect approximately 20 million individual tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The increased size of the 15-percent regular income tax rate bracket for married individuals filing joint returns should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision.

4. Increase the child tax credit (sec. 201 of the conference agreement)

Summary description of provision

The provision increases the child tax credit from $500 to $1,000, phased in over an ten-year period beginning in 2001, extends refundability of the credit, allows the credit to the extent of the full regular tax and alternative minimum tax, and repeals the provision that reduces the refundable child credit by the individual's alternative minimum tax.

Number of affected taxpayers

It is estimated that the provisions will affect approximately 25 million individual tax returns.

Discussion

Individuals should not have to keep additional records due to this provision, nor will additional regulatory guidance be necessary to implement this provision. More taxpayers will have to perform the additional calculations necessary to determine eligibility for the refundable child credit but this should not lead to an increase in disputes with the IRS. For taxpayer's with less than two children, however, the provision can be expected to increase tax preparation costs and the number of individuals using a tax preparation service. (See, also, the discussion of the interactive effect of the child credit and the individual alternative minimum tax, below.)

5. The effect of the alternative minimum tax rules

The provisions relating to the rate reductions, increased standard deduction, the expanded 15-percent rate bracket, and the increased child tax credit are affected by the alternative minimum tax rules. Although the bill provides relief from the alternative minimum tax, additional individuals will need to make the necessary calculations to determine the applicability of the alternative minimum tax rules. It is estimated that for the year 2010, 18 million additional individual income tax returns that will benefit from the rate reductions, increased standard deduction, expanded 15-percent rate bracket, and increased child tax credit would be affected by the alternative minimum tax. For these taxpayers, it could be expected that the interaction of the provisions with the alternative minimum tax rules would result in an increase in tax preparation costs and in the number of individuals using a tax preparation service.

The bill also provides that the alternative minimum tax exemption amount for married individuals filing a joint return is increased. This should reduce complexity for affected taxpayers. It is estimated that, for the year 2006, the provision increasing the alternative minimum tax exemption amount will apply to seven million individual income tax returns. Some of these taxpayers will no longer be affected by the alternative minimum tax.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, May 25, 2001.

Ms. LINDY L. PAULL,
Chief of Staff, Joint Committee on Taxation, Washington, DC.

DEAR MS. PAULL: Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department on the provisions of the conference agreement on the "Economic Growth and Tax Relief Reconciliation Act." Our comments are based on the description of these provisions contained in a brief summary of the conference agreement prepared by the staff of the Joint Committee on Taxation.

Due to the short turnaround time, our comments are necessarily provisional.

Sincerely,

CHARLES O. ROSSOTTI.

Enclosure.

COMPLEXITY ANALYSIS OF ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

NEW 10-PERCENT RATE BRACKET AND REDUCTION IN OTHER RATE BRACKETS

Provision

Create a new 10-percent regular income tax bracket ($6,000/$10,000/$12,000 of taxable income in 2001–2007 and $7,000/$10,000/$14,000 of taxable income in 2008 and thereafter; index in 2009); advance payments would be made to taxpayers in 2001.

Reduce the present-law regular income tax rates of 28, 31, 36, and 39.6 percent to 25, 28, 33, and 35 percent, respectively. The reduction is phased in over 6 years beginning July 1, 2001.

IRS and Treasury Comments

The new tax bracket and the reduced tax rates would be incorporated into the tax table and the tax rate schedules shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR–EZ, and 1041, and on Forms W–4V and 8814 for 2001 and later years. Other forms (e.g., Form 8752 and Schedule D (Form 1040)) would also be affected. No new forms would be required.

The new tax bracket and the reduced tax rates would also be incorporated into the tax rate schedules shown on Form 1040–ES for 2002 and later years. Subsequent to enactment, the IRS would have to advise taxpayers who make estimated tax payments for 2001 how they can adjust their estimated tax payments for 2001 to reflect the reduced rates.

Programming changes would be required to reflect the new tax bracket and rates for tax years 2001 through 2006. Currently, the IRS tax computation programs are updated annually to incorporate mandated inflation adjustments. Programming changes necessitated by the provision would be included during that process for 2002 and later years. Supplemental programming changes would be required to accommodate the new 10-percent tax bracket for 2001.

New withholding rate tables and schedules will be published soon after enactment to update the current Circular E for use by employers during the remainder of calendar year 2001.

The advance payment of the credit for 2001 would require a notice to explain the advance payment amount; programming changes to compute the advance payment amount; and resources to answer taxpayer questions about the payment.

The new credit for 2001 would require a new form to report to taxpayers the amount of the advance payment made to them; one new line to be added to Forms 1040, 1040A, and 1040EZ for taxpayers to compute the amount, if any, of their allowable credit; programming changes to compute the amount of the credit; and script

and other changes to enable TeleFile to compute the amount of the credit.

The alternative minimum tax (AMT) is projected to apply to an increasing number of taxpayers over time. The provision would increase the number of taxpayers, particularly in the later years of the budget period (2006–2011), whose liability is affected by the AMT, and would also cause additional taxpayers to perform AMT calculations to determine whether their liability is affected by the AMT.

CHILD TAX CREDIT

Provision

Increase the amount of the child tax credit to $600 (2001–2004), $700 (2005–2008), $800 (2009), and $1,000 (2010).

Make the child tax credit refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for 2001–2004 (15 percent for 2005 and later). The $10,000 figure would be indexed beginning in 2002.

Change the tax liability limitation for the child tax credit, including the order in which the credit is claimed, beginning in 2002. The child tax credit, but not the other personal nonrefundable credits, would be allowed against the sum of the regular tax and the alternative minimum tax. Under a new ordering rule, the foreign tax credit and the other nonrefundable personal credits would be taken into account before the child tax credit.

IRS and Treasury Comments

No new forms would be required as a result of any of the above-mentioned child tax credit provisions.

The increase in the amount of the child tax credit would be incorporated in the instructions for Forms 1040, 1040A, and 1040NR for 2001 and later years. This increase also affects the amount of the refundable child tax credit for residents of Puerto Rico and would be reflected in the instructions for Forms 1040–PR and 1040–SS for 2001 and later years.

The change in the tax liability limitation for 2002 and later years would:

1. Eliminate two questions from the instructions for Forms 1040 and 1040A.

2. Eliminate the need to refer taxpayers with three or more qualifying children and certain other personal nonrefundable credits to Publication 972 to compute their child tax credit. Such taxpayers will no longer be required to complete an additional 10-line worksheet (the "Line 11 Worksheet") in Publication 972.

3. Add three lines to the child tax credit worksheet in the Form 1040 instructions and one line to that worksheet in the Form 1040A instructions.

4. Change the ordering of the credits on Forms 1040, 1040A, and 1040NR.

Nine million additional taxpayers would be required to file Form 8812 to benefit from the provision that would make the child tax credit refundable to the extent of 15 percent of earned income in excess of $10,000. Form 8812 would be expanded from nine lines

to 13 lines, beginning in 2001. (A similar change will be necessary on Forms 1040–PR and 1040–SS for residents of Puerto Rico.)

The increase in the amount of the credit would be incorporated on Form 1040–ES for 2004, 2007, 2010, and 2011.

Supplemental programming changes would be required to accommodate the changes to the computation of the child tax credit for 2001.

As a result of this change, the number of taxpayers affected by the AMT would decrease.

STANDARD DEDUCTION FOR MARRIED TAXPAYERS FILING JOINTLY

Provision

Increase the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return, phased in over 5 years beginning in 2006.

IRS and Treasury comments

The increase in the basic standard deduction for married taxpayers would be incorporated in the instructions for Forms 1040, 1040A, 1040EZ, and on Forms 1040, 1040A, 1040EZ, and 1040–ES beginning in 2006. No new forms would be required.

Programming changes would be required to reflect the increased standard deduction for married taxpayers. Currently, IRS tax computation programs are updated annally to incorporate mandated inflation adjustments. Programming changes necessitated by this provision would be included during that process.

Compared with current law, the larger standard deduction would reduce the number of taxpayers who itemize deductions.

As a result of this provision, the number of taxpayers affected by the AMT would increase.

15-PERCENT RATE BRACKET FOR MARRIED TAXPAYERS FILING JOINTLY

Provision

Increase the width of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the width of the corresponding rate bracket for an unmarried individual filing a single return, phased in over 5 years beginning in 2006.

IRS and Treasury comments

The increase in the width of the 15-percent rate bracket for married taxpayers would be incorporated in the tax tables and the tax rate schedules shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR–EZ, and on Form 1040–ES for each year during the phase-in period (2006–2010). No new forms would be required.

Programming changes would be required to reflect the expanded 15-percent rate bracket. Currently, the IRS tax computation programs are updated annually to incorporate mandated inflation adjustments. Programming changes necessitated by the provision would be included during that process.

As a result of this provision, the number of taxpayers affected by the AMT would increase.

ESTIMATED BUDGET EFFECTS OF THE CONFERENCE AGREEMENT FOR H.R. 1836 [1]

Fiscal Years 2001 - 2011

[Millions of Dollars]

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
Marginal Rate Reduction Provisions (Sunset 12/31/10)														
1. Create new 10% bracket in 2001 through 2007 for the first $6,000 of taxable income for singles, first $10,000 for heads of households, and first $12,000 for married couples, and in 2008, first $7,000 of taxable income for singles, first $10,000 for heads of households, and first $14,000 for married couples; and index beginning in 2009; credit with advanced payment in lieu of rate for 2001	tyba 12/31/00	-38,186	-33,421	-40,223	-40,336	-40,201	-40,203	-40,065	-43,422	-45,359	-46,034	-13,871	-232,570	-421,321
2. Reduce the various income tax rates (39.6% rate reduced to 38.6% in 2001 through 2003, 37.6% in 2004 and 2005, 35% in 2006 and thereafter; 36% rate reduced to 35% in 2001 through 2003, and 34% in 2004 and 2005, and 33% in 2006 and thereafter; 31% rate reduced to 30% in 2001 through 2003, 29% in 2004 and 2005, 28% in 2006 and thereafter; 28% rate reduced to 27% in 2001 through 2003, 26% in 2004 and 2005, and 25% in 2006 and thereafter)	7/1/01	-2,005	-21,100	-21,256	-29,049	-32,774	-50,924	-59,378	-60,401	-61,652	-63,033	-19,035	-157,107	-420,606
3. Phasein repeal of Pease cutback of itemized deductions over 5 years	tyba 12/31/05	---	---	---	---	---	-1,265	-2,566	-4,003	-5,414	-7,168	-4,456	-1,265	-24,872
4. Phasein repeal of the personal exemption phaseout over 5 years	tyba 12/31/05	---	---	---	---	---	-473	-955	-1,382	-1,793	-2,216	-1,323	-473	-8,140
Total of Marginal Rate Reductions Provisions (Sunset 12/31/10)		**-40,191**	**-54,521**	**-61,479**	**-69,385**	**-72,975**	**-92,865**	**-102,964**	**-109,208**	**-114,218**	**-118,451**	**-38,685**	**-391,415**	**-874,939**
Increase the Child Tax Credit From $500 to $600 in 2001 through 2004, $700 in 2005 through 2008, $800 in 2009, and $1,000 in 2010; Make Refundable up to Greater of 15% (10% for 2001 through 2004) of Earned Income in Excess of $10,000 (Indexed in 2002) or Present Law; Allow Credit Permanently Against the AMT; Repeal AMT Offset of Refundable Credits; Sunset 12/31/10	**tyba 12/31/00**	**-518**	**-9,291**	**-9,927**	**-10,602**	**-12,786**	**-18,320**	**-19,000**	**-19,408**	**-20,532**	**-25,200**	**-26,197**	**-61,444**	**-171,782**
Marriage Penalty Relief Provisions (Sunset 12/31/10)														
1. Standard deduction set at 2 times single for married filing jointly, phased in over 5 years	tyba 12/31/04	---	---	---	---	-685	-1,954	-2,580	-2,772	-3,164	-2,932	-831	-2,639	-14,918
2. 15% rate bracket set at 2 times single for married filing jointly, phased in over 4 years	tyba 12/31/04	---	---	---	---	-4,208	-6,204	-6,559	-5,876	-4,737	-4,001	-1,150	-10,412	-32,734

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
3. EIC Modification and Simplification - increase in joint returns beginning and ending income level for phaseout by $1,000 in 2002 through 2004, $2,000 in 2005 through 2007, and $3,000 in 2008, and indexed thereafter; simplify definition of earned income; use AGI instead of modified AGI; conform definition of qualifying child and tie-breaker rules to those in JCT simplification study; and allow math error procedure with Federal Case registry data beginning in 2004 [2]	tyba 12/31/01	---	-8	-847	-1,277	-1,243	-1,817	-1,819	-1,787	-2,258	-2,240	-2,348	-5,191	-15,643
Total of Marriage Penalty Relief Provisions (Sunset 12/31/10)		---	**-8**	**-847**	**-1,277**	**-6,136**	**-9,975**	**-10,958**	**-10,435**	**-10,159**	**-9,173**	**-4,329**	**-18,242**	**-63,295**
Education Provisions (Sunset 12/31/10)														
1. Education IRAs - increase the annual contribution limit to $2,000; allow education IRA contributions for special needs beneficiaries above the age of 18; allow corporations and other entities to contribute to education IRAs; allow contributions until April 15 of the following year; allow a taxpayer to exclude Ed IRA distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; repeal excise tax on contributions made to education IRA when contribution made by anyone on behalf of same beneficiary to QTP; modify phaseout range for married taxpayers; allow tax-free expenditures for elementary and secondary school expenses; expand the definition of qualified expenses to include certain computers and related items	tyba 12/31/01	---	-203	-365	-461	-561	-667	-778	-892	-1,013	-1,136	-295	-2,256	-6,370
2. Qualified Tuition Plans - tax-free distributions from State plans; allow private institutions to offer prepaid tuition plans, tax-deferred in 2002, with tax-free distributions beginning in 2004; allow a taxpayer to exclude QTP distributions from gross income and claim the HOPE or Lifetime Learning credits as long as they are not used for the same expenses; expand definition of family member to include cousins; allow tax-free distributions for actual living expenses; ease rollover limitations; clarify coordination with the deduction for higher education expenses	tyba 12/31/01	---	-24	-53	-81	-111	-141	-170	-200	-234	-256	-64	-410	-1,334
3. Employer Provided Assistance - permanently extend the exclusion for undergraduate courses and graduate level courses	cba 12/31/01	---	-519	-720	-760	-804	-852	-904	-958	-1,012	-1,068	-267	-3,656	-7,865
4. Student loan interest - eliminate the 60-month rule; increase phaseout ranges to $50,000-$65,000 single/$100,000-$130,000 joint; indexed for inflation after 2002	ipa 12/31/01	---	-170	-245	-262	-277	-289	-305	-321	-338	-356	-89	-1,243	-2,651

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
5. Eliminate the tax on awards under the National Health Corps Scholarship program and F. Edward Hebert Armed Forces Health Professions Scholarship program	tyba 12/31/01	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	[3]	-4	-8
6. Increase arbitrage rebate exception for governmental bonds used to finance qualified school construction from $10 million to $15 million	bia 12/31/01	---	[3]	-3	-5	-6	-11	-15	-16	-17	-18	-19	-25	-109
7. Issuance of tax-exempt private activity bonds for qualified education facilities with annual State volume caps the greater of $10 per resident or $5 million	bia 12/31/01	---	-5	-19	-38	-61	-88	-120	-155	-191	-227	-251	-212	-1,156
8. Above-the-line deduction for qualified higher education expenses in 2002 through 2005	tyba 12/31/01	---	-1,535	-2,063	-2,683	-2,911	-730	---	---	---	---	---	-9,921	-9,921
Total of Education Provisions (Sunset 12/31/10)		**---**	**-2,457**	**-3,469**	**-4,291**	**-4,732**	**-2,779**	**-2,293**	**-2,543**	**-2,806**	**-3,062**	**-985**	**-17,727**	**-29,414**
Estate and Gift Provisions (Sunset 12/31/10)														
1. Phase In Repeal of Estate and Generation-Skipping Transfer Taxes - beginning in 2002, repeal the 5% "bubble" (which phases out the lower rates) and repeal rates in excess of 50%; in 2003, repeal rates in excess of 49%, in 2004 in excess of 48%, in 2005 in excess of 47%, in 2006 in excess of 46%, and in 2007 through 2009 in excess of 45%; reduce State death tax credit rates by 25% in 2002, 50% in 2003, 75% in 2004, and repeal in 2005; increase the unified credit to $1 million in 2002 and 2003, $1.5 million in 2004 and 2005, $2 million in 2006 through 2008, and $3.5 million in 2009; repeal section 2057 in 2004; repeal estate and generation-skipping transfer taxes in 2010; retain gift tax in 2010 and thereafter with $1 million lifetime gift exclusion and gift tax rates set at the highest individual income tax rate; carryover basis applies to transfers at death after 12/31/09 of assets fully owned by decedents, except: (1) $1.3 million of additional basis and certain loss carryforwards of the decedent are allowed to be added to carryover basis, and (2) an additional $3 million of basis is allowed to be added to carryover basis of assets going to surviving spouse; certain reporting requirements on bequests	dda & gma 12/31/01	---	---	-6,383	-5,031	-7,054	-4,051	-9,695	-11,862	-12,701	-23,036	-53,422	-22,519	-133,235
2. Expand Availability of Estate Tax Exclusion for Conservation Easements - repeal the 25-mile and 10-mile limits, and clarify the date for determining easement compliance	dda 12/31/00	---	-3	-19	-28	-29	-30	-32	-34	-36	-39	-42	-109	-292
3. Modifications to Generation-Skipping Transfer Tax Rules -														
a. Deemed allocation of the generation-skipping transfer tax exemption to lifetime transfers to trusts that are not direct skips	ta 12/31/00	---	-1	-3	-4	-4	-4	-4	-4	-4	-4	-4	-16	-36

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
b. Retroactive allocation of the generation-skipping tax exemption	generally 12/31/00	---	-1	-4	-6	-6	-6	-6	-6	-6	-6	-6	-23	-53
c. Severing of trusts holding property having an inclusion ratio of greater than zero	---	*Included in Item 3.b.*												
d. Modification of certain valuation rules	---	*Included in Item 3.b.*												
e. Relief from late elections	---	*Included in Item 3.b.*												
f. Substantial compliance	---	*Included in Item 3.b.*												
4. Expand Availability of Installment Payment Relief Under Section 6166 to:														
a. Increase from 15 to 45 the number of partners of a partnership or shareholders in a corporation eligible for installment payments of estate tax under section 6166	dda 12/31/01	---	---	-285	-297	-330	-364	-394	-383	-381	-371	-358	-1,276	-3,163
b. Qualified lending and finance business interests	dda 12/31/01	---	---	-103	-84	-64	-43	-21	-22	-24	-25	-27	-295	-413
c. Certain holding company stock	dda 12/31/01	---	---	-171	-140	-107	-72	-34	-47	-49	-42	-45	-491	-688
5. Waiver of statute of limitations for refunds of recapture of estate tax under section 2032A	DOE	---	-100	-25	---	---	---	---	---	---	---	---	-125	-125
Total of Estate and Gift Provisions (Sunset 12/31/10)		---	**-105**	**-6,993**	**-5,590**	**-7,594**	**-4,570**	**-10,186**	**-12,358**	**-13,201**	**-23,523**	**-53,904**	**-24,854**	**-138,005**
Pension and IRA Provisions (Generally Sunset 12/31/10)														
Individual Retirement Arrangement Provisions														
1. Modification of IRA Contribution Limits - increase the maximum contribution limit for traditional and Roth IRAs to: $3,000 in 2002 through 2004, $4,000 in 2005 through 2007, and $5,000 in 2008; index in years thereafter	tyba 12/31/01	---	-368	-847	-1,054	-1,693	-2,346	-2,582	-3,148	-3,817	-4,243	-3,033	-6,308	-23,132
2. IRA Catch-Up Contributions - increase maximum contribution limits for traditional and Roth IRAs for individuals age 50 and above by $500 in 2002 and $1,000 in 2006	tyba 12/31/01	---	-69	-151	-174	-176	-225	-293	-252	-211	-234	-162	-795	-1,968
3. Deemed IRAs under employee plans	pyba 12/31/02	*Negligible Revenue Effect*												
Total of Individual Retirement Arrangement Provisions		---	-437	-998	-1,228	-1,869	-2,571	-2,875	-3,400	-4,028	-4,477	-3,215	-7,103	-25,100
Provisions for Expanding Coverage														
1. Increase contribution and benefit limits:														
a. Increase limitation on exclusion for elective deferrals to: $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, and $15,000 in 2006; index thereafter [4] [5]	yba 12/31/01	---	---	-100	-328	-500	-636	-708	-753	-797	-880	-436	-1,564	-5,138
b. Increase limitation on SIMPLE elective contributions to: $7,000 in 2002, $8,000 in 2003, $9,000 in 2004, and $10,000 in 2005; index thereafter [4] [5]	yba 12/31/01	---	-10	-30	-42	-51	-55	-59	-63	-66	-69	-35	-188	-480
c. Increase defined benefit dollar limit to $160,000	yba 12/31/01	---	-23	-42	-46	-47	-48	-49	-54	-57	-56	-8	-207	-432
d. Lower early retirement age to 62; lower normal retirement age to 65	yba 12/31/01	---	-3	-4	-4	-5	-5	-5	-5	-5	-5	-2	-21	-43
e. Increase annual addition limitation for defined contribution plans to $40,000 with indexing in $1,000 increments [4]	yba 12/31/01	---	-7	-15	-19	-21	-17	-17	-20	-23	-27	-14	-79	-180

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
f. Increase qualified plan compensation limit to $200,000 with indexing in $5,000 increments [4] and expand availability of qualified plans to self-employed individuals who are exempt from the self-employment tax by reason of their religious beliefs	yba 12/31/01 & tyba 12/31/01	---	-55	-119	-125	-143	-141	-157	-154	-170	-184	-98	-583	-1,346
g. Increase limits on deferrals under deferred compensation plans of State and local governments and tax-exempt organizations to: $11,000 in 2002, $12,000 in 2003, $13,000 in 2004, $14,000 in 2005, and $15,000 in 2006; index thereafter [4] [5]	yba 12/31/01	---	-29	-61	-87	-108	-127	-138	-147	-155	-164	-84	-411	-1,098
2. Plan loans for S corporation owners, partners, and sole proprietors	yba 12/31/01	---	-21	-32	-34	-36	-39	-41	-44	-47	-49	-19	-162	-362
3. Modification of top-heavy rules	yba 12/31/01	---	-4	-8	-10	-11	-13	-14	-16	-17	-19	-10	-45	-121
4. Elective deferrals not taken into account for purposes of deduction limits	yba 12/31/01	---	-47	-88	-103	-111	-119	-127	-135	-144	-152	-103	-468	-1,129
5. Repeal of coordination requirements for deferred compensation plans of State and local governments and tax-exempt organizations [4]	yba 12/31/01	---	-16	-27	-27	-25	-23	-24	-24	-24	-24	-14	-118	-228
6. Elimination of user fee for certain requests regarding small employer pension plans with at least one non-highly compensated employee [6]	rma 12/31/01	---	-7	-10	---	---	---	---	---	---	---	---	-17	-17
7. Definition of compensation for purposes of deduction limits [4]	yba 12/31/01	---	-1	-3	-3	-3	-3	-4	-4	-4	-4	-2	-14	-31
8. Increase stock bonus and profit sharing plan deduction limit from 15% to 25% [4]	tyba 12/31/01	---	-7	-14	-16	-18	-19	-21	-23	-24	-26	-14	-75	-182
9. Option to treat elective deferrals as after-tax Roth contributions	yba 12/31/05	---	---	---	---	---	185	236	172	90	-5	-358	185	320
10. Nonrefundable credit to certain individuals for elective deferrals and IRA contributions (sunset 12/31/06)	tyba 12/31/01	---	-1,036	-2,096	-1,963	-1,856	-1,746	-920	-102	-91	-89	-86	-8,698	-9,987
11. Small business (100 or fewer employees) tax credit for new retirement plan expenses - first 3 years of the plan	[7]	---	-3	-12	-21	-29	-29	-29	-27	-26	-25	-22	-94	-223
12. Treatment of nonresident aliens engaged in international transportation services	tyba 12/31/01	---	-2	-7	-7	-7	-8	-8	-8	-8	-8	-5	-31	-68
Total of Provisions for Expanding Coverage		---	-1,271	-2,668	-2,835	-2,971	-2,843	-2,085	-1,407	-1,568	-1,786	-1,310	-12,590	-20,745
Provisions for Enhancing Fairness for Women														
1. Additional catch-up contributions for individuals age 50 and above - increase the otherwise applicable contribution limit for all plans other than SIMPLE by $1,000 in 2002, $2,000 in 2003, $3,000 in 2004, $4,000 in 2005, and $5,000 in 2006 and thereafter; index in $500 increments after 2006; SIMPLE plan catch-ups would be 50% of that applicable to other plans; (nondiscrimination rules would not apply) [4]	tyba 12/31/01	---	-124	-243	-234	-164	-100	-84	-76	-63	-57	-38	-865	-1,184
2. Equitable treatment for contributions of employees to defined contribution plans [4]	yba 12/31/01	---	-45	-84	-98	-106	-113	-121	-129	-136	-144	-75	-446	-1,051

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
3. Faster vesting of certain employer matching contributions	cf pyba 12/31/01	*Negligible Revenue Effect*												
4. Simplify and update the minimum distribution rules by modifying post-death distribution rules	yba 12/31/01	---	[3]	-1	-1	-2	-2	-2	-2	-2	-3	-3	-6	-18
5. Clarification of tax treatment of division of section 457 plan benefits upon divorce	tdapma 12/31/01	*Negligible Revenue Effect*												
6. Modification of safe harbor relief for hardship withdrawals from 401(k) plans	yba 12/31/01	*Negligible Revenue Effect*												
7. Waiver of tax on nondeductible contributions for domestic or similar workers	tyba 12/31/01	---	[3]	[3]	-1	-2	-4	-6	-8	-10	-12	-14	-8	-57
Total of Provisions for Enhancing Fairness for Women		---	-169	-328	-334	-274	-219	-213	-215	-211	-216	-130	-1,325	-2,310
Provisions for Increasing Portability for Participants														
1. Rollovers allowed among governmental section 457 plans, section 403(b) plans, and qualified plans	da 12/31/01	---	27	-4	-4	-5	-5	-5	-6	-6	-7	-43	10	-57
2. Rollovers of IRAs to workplace retirement plans	da 12/31/01	*Negligible Revenue Effect*												
3. Rollovers of after-tax retirement plan contributions	dma 12/31/01	*Negligible Revenue Effect*												
4. Waiver of 60-day rule	da 12/31/01	*Negligible Revenue Effect*												
5. Treatment of forms of qualified plan distributions	yba 12/31/01	*Negligible Revenue Effect*												
6. Rationalization of restrictions on distributions	da 12/31/01	*Negligible Revenue Effect*												
7. Purchase of service credit in governmental defined benefit plans	ta 12/31/01	*Negligible Revenue Effect*												
8. Employers may disregard rollovers for cash-out amounts	da 12/31/01	*Negligible Revenue Effect*												
9. Minimum distribution and inclusion requirements for section 457 plans	da 12/31/01	*Considered in Other Provisions*												
Total of Provisions for Increasing Portability for Participants		---	27	-4	-4	-5	-5	-5	-6	-6	-7	-43	10	-57
Provisions for Strengthening Pension Security and Enforcement														
1. Phase-in repeal of 160% of current liability funding limit; extend maximum deduction rule	pyba 12/31/01	---	-14	-20	-36	-36	-38	-38	-39	-41	-42	-22	-144	-326
2. Excise tax relief for sound pension funding	yba 12/31/01	---	-2	-3	-3	-3	-3	-3	-3	-3	-3	-3	-14	-29
3. Notice of significant reduction in plan benefit accruals	pateo/a DOE	*Negligible Revenue Effect*												
4. Repeal 100% of compensation limit for multiemployer plans	yba 12/31/01	---	-2	-4	-4	-4	-4	-5	-5	-5	-5	-3	-18	-41
5. Modification of section 415 aggregation rules for multiemployer plans	tyba 12/31/01	---	-1	-1	-1	-1	-1	-1	-1	-1	-1	-1	-4	-8
6. Investment of employee contributions in 401(k) plans	aiii TRA'97	*Negligible Revenue Effect*												
7. Prohibited allocations of stock in an ESOP S corporation	[8]	---	3	5	6	8	8	9	10	10	10	11	30	81
8. Automatic rollovers of certain mandatory distributions	dma frap	---	---	---	-7	-29	-30	-32	-33	-33	-34	-26	-66	-224
9. Clarification of treatment of contributions to multiemployer plans	yea DOE	---	---	-11	-19	-32	-38	-35	-30	-26	-19	-14	-100	-224
Total of Provisions for Strengthening Pension Security and Enforcement		---	-16	-34	-64	-97	-106	-105	-101	-99	-94	-58	-316	-771

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
Provisions for Reducing Regulatory Burdens														
1. Modification of timing of plan valuations	pyba 12/31/01	*Negligible Revenue Effect*												
2. ESOP dividends may be reinvested without loss of dividend deduction	tyba 12/31/01	---	-20	-49	-59	-63	-66	-69	-71	-74	-77	-39	-258	-588
3. Repeal transition rule relating to certain highly compensated employees	pyba 12/31/01	---	-2	-3	-3	-3	-3	-4	-4	-4	-4	-2	-14	-32
4. Employees of tax-exempt entities [9]	DOE	*Negligible Revenue Effect*												
5. Treatment of employer-provided retirement advice	yba 12/31/01	*Negligible Revenue Effect*												
6. Repeal of multiple use test	yba 12/31/01	*Considered in Other Provisions*												
Total of Provisions for Reducing Regulatory Burdens		---	-22	-52	-62	-66	-69	-73	-75	-78	-81	-41	-272	-620
Miscellaneous Provision - Allow electing Alaska Native Settlement Trusts to tax income to the Trust not the beneficiaries [11]	[12]	---	-4	-4	-3	-3	-3	-3	-3	-4	-4	-1	-17	-33
Total of Pension and IRA Provisions (Generally Sunset 12/31/10)		**---**	**-1,892**	**-4,088**	**-4,530**	**-5,285**	**-5,816**	**-5,359**	**-5,207**	**-5,994**	**-6,665**	**-4,798**	**-21,613**	**-49,636**
AMT Relief - Increase Exemption by $2,000 (Single) and $4,000 (Joint) in 2001 through 2004; Sunset 12/31/04	**tyba 12/31/00**	**-178**	**-2,311**	**-3,161**	**-4,605**	**-3,646**	**---**	**---**	**---**	**---**	**---**	**---**	**-13,901**	**-13,901**
Modification to Corporate Estimated Tax Requirements; Special Estimated Tax Rules for Certain 2001 and 2004 Corporate Estimated Tax Payments	**DOE**	**-32,921**	**32,921**	**---**	**-6,606**	**6,606**	**---**	**---**	**---**	**---**	**---**	**---**	**---**	**---**
Expansion of Authority to Postpone Certain Tax Deadlines Due to Disaster (Sunset 12/31/10)	**doa DOE**	**---**	**[3]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[13]**	**[14]**
Miscellaneous Provisions (Generally Sunset 12/31/10)														
1. Adoption credit - increase the expense limit and the exclusion to $10,000 for both non-special needs and special needs adoptions, and beginning in 2003, make the credit independent of expenses for special needs adoptions, permanently extend the credit and the exclusion, increase the phase-out start point to $150,000, index for inflation the expenses limit and the phase-out start point for both the credit and the exclusion, and allow the credit to apply to the AMT	generally tyba 12/31/01	---	-51	-191	-252	-293	-325	-349	-375	-403	-432	-464	-1,112	-3,135
2. Provide an employer-provided child care credit of 25% for child care expenditures and 10% for child care resource and referral expenditures	tyba 12/31/01	---	-48	-108	-129	-142	-156	-169	-178	-188	-196	-90	-584	-1,405
3. Exclude from gross income certain payments made to Holocaust survivors or their heirs	aro/a 1/1/00	---	---	-3	-3	-3	-3	-3	-3	-3	-3	-3	-14	-31

Provision	Effective	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
4. Dependent care tax credit - increase the credit rate to 35%, increase the eligible expenses to $3,000 for one child and $6,000 for two or more children (not indexed), and increase the start of the phase-out to $15,000 of AGI	tyba 12/31/02	---	---	-336	-432	-413	-393	-380	-352	-317	-296	-73	-1,573	-2,991
Total of Miscellaneous Provisions (Generally Sunset 12/31/10)		---	-99	-638	-816	-851	-877	-901	-908	-911	-927	-630	-3,283	-7,562
NET TOTAL [15] [16]		-73,808	-37,763	-90,602	-107,702	-107,399	-135,202	-151,661	-160,067	-167,821	-187,001	-129,528	-552,480	-1,348,537

Joint Committee on Taxation

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

Legend for "Effective" column:

aiii TRA'97 = as if included in the Taxpayer Relief Act of 1997
aro/a = amounts received on or after
bia = bonds issued after
cba = courses beginning after
cf = contributions for
bia = bonds issued after
da = distributions after
dda = decedents dying after
doa = disasters occurring after
dma = distributions made after
DOE = date of enactment
frap = Federal regulations are prescribed
gma = gifts made after
iafpbnet = interest accruing for periods beginning not earlier than
ipa = interest paid after
noitta = notice of intent to terminate after
pateo/a = plan amendments taking effect on or after
pea = plans established after
pyba = plan years beginning after
rma = requests made after
ta = transfers after
tdapma = transfers, distributions, and payments made after
tyba = taxable years beginning after
yba = years beginning after
yea = years ending after

[1] The estimates presented in this table include the effects of certain behavioral responses to the tax proposals, including shifts between nontaxable and taxable sources of income, changes in amounts of charitable giving, and changes in the timing of realization of some sources of income. While the estimates do not include the effects of these proposals on economic growth, the proposals are likely to result in modest increases in growth of the economy during the 10-year budget estimating period. The largest component of the proposals, the marginal rate cuts, will provide incentives for more work, investment, and savings.
[2] Estimate assumes that any constitutional challenge based on the use of Federal Case registry data would not be successful.
[3] Loss of less than $500,000.
[4] Provision includes interaction with other provisions in Provisions for Expanding Coverage.
[5] Provision includes interaction with the Individual Retirement Arrangement Provisions.
[6] Estimate provided by the Congressional Budget Office.
[7] Effective for costs paid or incurred in taxable years beginning after December 31, 2001, with respect to qualified employer plans established after such date.
[8] Generally effective with respect to years beginning after December 31, 2004. In the case of an ESOP established after March 14, 2001, or an ESOP established on or before such date if the employer maintaining the plan was not an S corporation on such date, the proposal would be effective with respect to plan years ending after March 14, 2001.
[9] Directs the Secretary of the Treasury to modify rules through regulations.
[10] Effective for distributions from terminating plans that occur after the PBGC has adopted final regulations implementing provision.
[11] Special Federal income tax rules would apply if the Trust makes an election for its first taxable year ending after the date of enactment.
[12] Effective for taxable years of electing Settlement Trusts ending after the date of enactment, and to contributions made to such trust made after the date of enactment.
[13] Loss of less than $1 million.
[14] Loss of less than $5 million.

[15] Includes the following effect on fiscal year	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2001-06	2001-11
outlays (millions)	---	6,226	6,600	7,006	7,081	9,597	9,542	9,360	9,668	11,080	12,244	36,510	88,404

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
[16] Taxpayers affected by the AMT: Present Law (millions of taxpayers)	1.5	3.5	4.3	5.6	7.1	8.7	10.5	12.8	14.9	17.5	20.7
Taxpayers affected by the AMT: Proposal (millions of taxpayers)	1.4	2.7	3.3	5.3	13.0	19.6	23.9	29.1	32.1	35.5	20.7

WILLIAM THOMAS,
DICK ARMEY,
Managers on the Part of the House.

CHUCK GRASSLEY,
ORRIN HATCH,
FRANK H. MURKOWSKI,
DON NICKLES,
PHIL GRAMM,
MAX BAUCUS,
JOHN BREAUX,
Managers on the Part of the Senate.

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