UNITED STATES SENATE
REPUBLICAN
POLICY COMMITTEE

Larry E. Craig, Chairman
Jade West, Staff Director

No. 9 May 16, 2001

S. 896 – Tax Reconciliation Bill (RELIEF Act of 2001)

Ordered reported by the Senate Committee on Finance on May 15, 2001, by a bipartisan vote of 14-6 (all Committee Republicans were joined by Senators Baucus, Breaux, Lincoln, and Torricelli, in voting aye).

NOTEWORTHY

- By unanimous consent, the Senate will take up S. 896, the Tax Relief Reconciliation Act, on Thursday, May 17.

- Under the FY 2002 budget resolution adopted by Congress (H.Con.Res. 83), the Finance Committee was instructed to report legislation by May 18 to reduce revenues in the years 2001 through 2011 by $1.25 trillion and increase outlays by $100 billion. This bill meets the requirements, affording it the procedural protections of budget reconciliation legislation [see Floor Procedure, pp.7-8]. The Finance and Ways & Means Committees were the sole recipients of reconciliation instructions in the budget resolution this year.

- Among the strict rules governing floor consideration of reconciliation legislation, the motion to proceed to the bill is not debatable, and floor debate is limited to 20 hours. It is the Majority Leader's intention to complete action on the bill by Monday, May 21.

- The Tax Relief Reconciliation Act of 2001 would be the most significant tax cut enacted into law since the Economic Recovery Tax Act was signed by Ronald Reagan in 1981.

- The bill would reduce revenues (and outlays) by $1.35 trillion through 2011, including:

Relief Act Provision	Revenue Reduction
Rate Reduction	$847 Billion
Death Tax Repeal	$145 Billion
Marriage Penalty	$60 Billion
Child Tax Credit	$190 Billion
Education Credits	$33 Billion
Pension Reform	$40 Billion
Total	**$1.347 Billion**

HIGHLIGHTS

Below is a summary of the major tax provisions included in the Tax Relief Reconciliation Act. A full description of all the provisions can be found on the Joint Committee on Taxation's website: http://www.house.gov/jct/x-40-01.pdf. Chairman Grassley made several modifications to his mark during the markup. Descriptions of these modifications are found on the Joint Committee's website.

Marginal Rate Reduction

In keeping with the President's call to reduce the record tax burden through marginal income tax rate reductions, the Tax Relief Act shifts the entire marginal rate structure down, from the current range of 15-39.6 percent to 10-36 percent by 2007. In addition, the Act repeals limitations on certain deductions that have the effect of raising the top income tax brackets by several percentage points.

The Relief Act creates a new, 10-percent tax bracket for income up to $6,000 for individuals and $12,000 for married couples. The bracket is applied retroactively to the beginning of the year (2001), resulting in $9.3 billion in tax relief for American families before September 30th. This provision saves typical single taxpayers $300 and married couples $600 per year.

The economic growth potential in the Tax Relief Act is contained in the marginal-rate reduction of the upper-income tax brackets. In an effort to reduce the overall revenue impact and to gain reluctant Democratic support, this relief is considerably smaller than that proposed by the President and supported by American voters. Whereas the President called for reducing the top marginal tax rate from 39.6 to 33 percent, the top rate under the Tax Relief Act falls to 36 percent six years from now, in 2007. Here is the rate schedule under the bill for the upper rates:

Calendar Year	28% Bracket	31% Bracket	36% Bracket	39.6% Bracket
2002-04	27%	30%	35%	38.6%
2005-06	26%	29%	34%	37.6%
2007 and Later	25%	28%	33%	36.0%

Phase-Out Relief

One area where the Tax Relief Act outperforms the President's proposal is in its treatment of the rate bubble that affects certain families. This bubble is the result of two provisions that reduce the value of a taxpayer's itemized deductions and personal exemption(s). The net effect of these provisions – known as PEP and Pease – is to raise effective marginal tax rates by several percentage points. Reducing their impact has the same pro-growth impact as cutting the statutory rates.

Itemized Deduction Phased-Out (Pease): Under law, a taxpayer's itemized deductions are reduced by 3 percent of income in excess of $132,950 (in 2001). This reduction is limited to 80 percent of the taxpayer's total itemized deductions. In essence, the tax code takes back three cents of deductions for every dollar a taxpayer earns above the Pease threshold. The Relief Act raises this threshold to conform with the Personal Exemption Phase-Out threshold. This increase is effective beginning in 2009, and is estimated to raise the threshold at that point to $245,500.

Personal Exemption Phase-Out (PEP): Current law also discounts the value of personal exemptions once a taxpayer rises above a certain income threshold. The deduction for the personal exemption is reduced by 2 percent for every $2,500 a taxpayer earns above the threshold of $132,950 ($199,450 for married couples). By the time a taxpayer's income rises to $255,450 ($321,950 for married couples), the value of the standard deduction is completely gone. The Relief Act would eliminate this phase-out beginning in 2009.

Death Tax Repeal

The Tax Relief Act includes several provisions to reduce the impact of the death tax on estates, culminating in the ultimate repeal of the tax in 2011.

Unified Credit and Rate Reduction: Thanks to the Taxpayer Relief Act of 1997, the unified credit currently shields $675,000 of an estate from the death tax. This level is scheduled to increase to $1 million by 2006. The Tax Relief Act aggressively raises the value of the unified credit over the next nine years. At the same time, the Relief Act reduces the top rate imposed by the death tax – the highest remaining rate in our tax code – over the next eight years. Here is the schedule for exemption increases and rate reductions:

Calendar Year	Estate Tax Exemption	Top Estate Tax Rate
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	Tax Repealed	Tax Repealed

Repeal: The Relief Act repeals the death tax beginning in 2011. In an effort to ensure that appreciated assets do not avoid taxation, and to respond to concerns by the Joint Committee on Taxation regarding aggressive tax avoidance, the bill includes numerous provisions affecting the disposition of estates following their owner's deaths. Here is a summary of the two most significant provisions:

Modified Carryover Basis: The bill would replace the current unlimited step-up in basis with a limited step-up for transferred assets up to a certain amount. Currently, all assets transferred following the death of their owner receive a step-up in basis. The Relief Act would replace this universal step-up with a step-up limited to $1.3 million of the total assets transferred. For assets transferred to a spouse, the limit would be $3 million. Similar to the bill that passed the Senate last year, this bill requires larger estates to "carry over" basis of any assets transferred.

<u>Gift Tax</u>: In an effort to address concerns by Democrats and the Joint Committee on Taxation, the bill retains the Gift Tax following repeal of the death tax and associated generation-skipping taxes. Concerns were raised that without a Gift Tax, taxpayers could make nontaxable gifts back and forth to avoid income, capital gains, and other taxes. The bill imposes a 40-percent Gift Tax beginning in 2011 with a $1 million lifetime gift exclusion.

Marriage Penalty Relief

A marriage penalty exists when a married couple filing a joint tax return pays higher taxes than if the same couple were not married and filed as individuals. According to the Congressional Budget Office, almost half of all married couples — 22 million — suffered from the marriage penalty in 1999. The average penalty paid by these couples was $1,500.

Generally speaking, the marriage penalty is the result of 1) a higher combined standard deduction for two workers filing as singles than for married couples and 2) income tax bracket thresholds for married couples that are less than twice the threshold for single taxpayers. Family groups also argue that single-earner couples face an additional tax penalty due to the repeal of income splitting.

The Tax Relief Act addresses the Marriage Penalty by making the following changes to the tax code:

<u>Standard Deduction</u>: The bill increases the standard deduction for married couples filing jointly to twice the standard deduction for single taxpayers, phased in over five years beginning in 2006.

<u>Increased Brackets</u>: The bill expands, over a five-year period, the 15-percent income tax bracket for a married couple filing a joint return to twice the size of the corresponding brackets for an individual filing a single return. Again, the phase-in period begins in 2006.

<u>Earned Income Credit</u>: The bill increases the beginning and the end of the phase-out of the Earned Income Credit for couples filing a joint return by $3,000, beginning in 2002.

Child Credit

Under current law, taxpayers may claim a $500 tax credit for each qualified child under the age of 17, once again thanks to the Taxpayer Relief Act of 2001. The credit begins to phase out for taxpayers with modified adjusted income of $75,000 ($110,00 for married taxpayers). With a small exception, this credit is not refundable.

The Tax Relief Act would increase the Child Credit to $1,000 over the next 10 years. The phase-out income levels remain the same as current law. The bill also would make the credit partially refundable for some families with little or no income tax liability.

Calendar Year	Credit Amount Per Child
2001-03	$600
2004-06	$700
2007-09	$800
2010	$900
2011 and Later	$1,000

Education Provisions

The Act includes numerous provisions designed to reduce the cost of education, and is similar to provisions in S. 763, as reported by the Finance Committee (S. Rept. 107-12; Senate Calendar No. 34), including the following:

Education IRAs (Education Savings Accounts): The bill increases the annual contribution limit from $500 to $2,000 for education IRAs and expands the definition of "qualified education expenses" to include the costs of elementary and secondary education. The new $2,000 limit is effective as of January 1, 2002. In addition to other changes, the bill redesignates Education IRAs as Coverdell Education Savings Accounts.

Qualified State Tuition Programs: The bill provides for the tax-exempt treatment of funds distributed from a qualified state tuition program. Amounts distributed for the qualified education expenses of attending a college, university (including graduate school), or vocational school are not included in the gross income of the contributor (or the beneficiary) for tax purposes.

Employer-Provided Education Assistance: The bill makes permanent the exclusion from an employee's gross income amounts paid or incurred by an employer for education assistance provided to the employee. The provision also extends the exclusion to include graduate education.

Student Loan Interest Deduction: Current law allows certain individuals who have paid interest on qualified education loans to claim an above-the-line deduction for the first 60 months of required interest payments. The bill repeals the 60-month limitation and allows qualified individuals to take a deduction for all interest paid. The bill also increases the income level at which this deduction is phased out.

Tax-Free Treatment of National Health Corps Scholarships: The bill would allow students who receive a National Health Corps scholarship to exclude the dollar value of the scholarship from their gross income for tax purposes.

Pension Reforms

The bill includes more than 50 pension-reform provisions, including increased contribution limits, an allowance for women reentering the workforce to make catch-up contributions to their pension plans, an increase in the portability of private and public pension plans, and a reduction in the regulatory burden shouldered by employers who offer savings plans. The pension provisions are similar to those in S. 742, the Retirement Security and Savings Act, which is pending before the Finance Committee. Also, many similar provisions were included in legislation, H.R. 10, that passed the House May 2 by a vote of 407-24. Major provisions include:

Increased Savings Incentives: The measure increases contribution and benefit limits in tax-favored retirement plans, including 1) increasing maximum allowable IRA contributions from $2,000 to $5,000 and 2) increasing contribution limits for 401(k), 403(b), and 457 plans from $10,500 to $15,000.

Enhancing Fairness for Women: The report contains several provisions designed to assist women workers in preparing for their retirement. These provisions include allowing workers over 50 years old to make additional salary reduction "catch-up" contributions, and accelerated vesting requirements for employer matching contributions.

Pension Security: The report requires employers who change their pension plans to notify their employees of the change in advance.

Pension Simplification: In addition, the report modifies and simplifies "top-heavy rules" on small businesses establishing pension plans, and contains other provisions designed to reduce the complexity of plan administration.

Portability: The report increases portability of retirement assets so employees may roll over such assets from one job to the next. These provisions will benefit local and state government employees, as well as private-sector employees.

FLOOR PROCEDURE

Reconciliation Procedures

Bills considered by the Senate under budget reconciliation are debated under unique procedures not afforded other legislation. Here's a quick list of the major differences:

- The motion to proceed is not debatable.
- Floor debate is limited to 20 hours, equally divided.

- Time spent on quorum calls — unless preceding a vote — is counted against the total time, but time spent voting is not.
- Debate on first-degree amendments is limited to two hours. That time must expire or be yielded back before a vote can take place or a second-degree amendment can be offered.
- Debate on second-degree amendments is limited to one hour.
- Any debatable motions or appeals of the Chair's ruling carry a one-hour time limit.
- Once the 20 hours has expired, amendments may still be offered and voted upon, but they cannot be debated.

Germaneness and the Byrd Rule

Amendments to a reconciliation bill must be germane, fully offset, and in compliance with the Byrd Rule. Otherwise, a 60-vote point of order lies against them. This rule of thumb does not apply to motions to strike, which are always in order.

Under the precedents of the Senate, germaneness is a more narrow concept than a simple "relevance" test, which only considers subject matter. The following types of amendments are considered germane:

- Committee amendments resulting from a motion to recommit;
- Amendments to strike;
- Amendments to change numbers or dates; and
- Nonbinding amendments limited to matters within the jurisdiction of the committee of the reported bill.

For any amendment that does not fall into one of the categories above, germaneness is determined on a case-by-case basis by the Parliamentarian. In addition to being germane, all amendments must be offset for the first year and the sum of the first five years to avoid a Budget Act point of order.

Finally, an amendment must comply with the Byrd Rule. The Byrd Rule is designed to protect reconciliation bills from being filled with amendments not related to spending and revenue matters. This rule, named after Senator Robert C. Byrd (D-WV), applies the following rules to any legislation, amendment, or conference report considered under reconciliation. Material is considered extraneous if it:

- Doesn't change outlays or revenues (unless it is a term or condition of a provision that does produce such a change);
- Increases the deficit if the committee has failed to meet its instruction;
- Is a provision from a committee which has no jurisdiction over the provision;
- Would produce changes in outlays or revenues which are incidental to the non-budgetary components of the provision;

- Creates a net outlay increase or a revenue decrease in the year following the scoring window; or
- Affects the receipts or outlays of the Social Security trust fund.

If a Byrd Rule point of order against a provision in the bill is sustained, the offending provision is stricken from the bill. A waiver of the Byrd Rule requires 60 votes. The Senate Budget Committee is required to produce a list of Byrd Rule violations in any reconciliation bill or conference report.

ADMINISTRATION POSITION

At Press time, no Statement of Administration Policy was available.

COST

The Joint Committee on Taxation estimates that the bill would decrease revenues (and increase outlays) by $1.35 trillion from FY 2001 to 2011. The complete revenue estimate is located at: http://www.house.gov/jct/x-41-01.pdf.

POSSIBLE AMENDMENTS

Hatch. To include a permanent extension of the R&D tax credit.

Allen. Tax Accelerator Amendment.

Gregg. Temporary capital gains reduction.

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