DEPARTMENT OF THE TREASURY
WASHINGTON, D.C. 20220

June 20, 1997

**MEMORANDUM FOR SECRETARY ROBERT E. RUBIN**
**DEPUTY SECRETARY SUMMERS**

**FROM:** **KARL SCHOLZ** KS
**DEPUTY ASSISTANT SECRETARY (TAX ANALYSIS)**

**SUBJECT:** EITC and Child Credit Stacking Order in the Finance Committee Bill

There is a lot of confusion about what was done in the Finance Committee on the EITC and child credit stacking. We believe that Chairman Roth and others in the committee misstated the content of the EITC change Thursday night. We were told that families could take half the child credit, then take the EITC, and then receive the remaining portion of their EITC. What in fact was done is have families calculate half their EITC, then take the child credit, and then take the other half of the EITC. This discrepancy makes a major, unfortunate difference in the progressivity of the proposal.

Stacking the child credit before the EITC, as we propose rather than after the EITC, would cost roughly $10 billion more over 5 years. Adopting the "halfway" measure that we prefer (half the child credit first) would cost in the neighborhood of $6 billion more. The halfway measure that was adopted by the Senate Finance Committee will cost roughly $2.5 billion more.

A couple examples illustrate the importance of this issue.

- A two-parent family with two children making $20,000 would have a standard deduction and personal exemptions of $18,500 in 1999, and taxable income of $1,500. This family would pay $225 of income taxes. They would pay $1,530 in payroll taxes and their employer would pay another $1,530 in payroll taxes on their behalf. Their EITC would be $2,300. There are three points to make from this example:

  - First, the Senate Finance Committee's measure that stacks half the EITC before the child credit ensures that this family <u>receives no benefit from the child credit</u>. With the alternative measure (stacking half or all the child credit before the EITC), the family would receive $225 of child credit.

  - Second, the stacking order of the child credit only affects families who have positive federal tax liabilities. Two-parent, two-child families, for example, will only start paying taxes in 1999 when their incomes exceed $18,500. Stacking order is no longer an issue when the combined value of the child credit and EITC is less than the amount of federal tax liability. For the two-parent, two-child example, this occurs at roughly $28,500 of income.

-- The stacking order debate is not about families on welfare. It is about how we want to treat working families with children who have incomes between $18,000 and $28,000 of income.

- Third, families with income between $18,000 and $28,000 pay more in payroll and income taxes than what they would get from the EITC and child credit, even when stacked the way we would like. The family in the example given above pays $225 in federal income taxes and $3,060 in employer- and employee-paid payroll taxes. They would receive a $2,300 EITC and possibly a $225 child credit. The analysis does not account for other major taxes such as federal excise taxes on alcohol, tobacco, and gasoline, or state and local sales, property and income taxes.

o A two-parent family with two children making $25,000 would have a standard deduction and personal exemptions of $18,500 in 1999, and taxable income of $6,500. This family would pay $975 of income taxes. They would pay $1,912.50 in payroll taxes and their employer would pay another $1,912.50 in payroll taxes on their behalf. Their EITC would be $1,042.

  - Stacking the child credit after half the EITC, as in the Senate Finance Committee bill, the family would get a child credit of $454.

  - Stacking the EITC after half the child credit, as we thought the Senate Finance Committee was going to do, would generate a child credit of $500.

  - Stacking the child credit before the EITC, as we would like to see happen, would generate a child credit of $1,000.

    -- This family would pay $4,800 in federal income taxes and the employer and employee share of payroll taxes. Their combined EITC and child credit (if stacked the way we would like) would be $2,042. Again, tax payments for these families sharply exceed what they would receive in credits.

## The EITC and Taxation of Low Income Workers

- EITC recipients and other low income workers are taxpayers. About 85 percent of EITC payments offset the Federal tax burden of low and moderate income families. This figure does not reflect the myriad state and local taxes paid by these workers.

- The EITC and child credit are not welfare. In fact, a child credit, like the EITC would help workers stay in the labor force and off of welfare, by increasing their take-home pay. The EITC is currently the only credit designed to offset high marginal tax rates inherent in the social security and welfare systems; as such, it is a cornerstone for welfare reform. Dickert et al. (1995) estimated that EITC increases between 1993 and 1996 would induce 516,000 families to move from welfare to the workforce, saving $2 billion per year (net of the increase in EITC payments to these families).

- Unlike welfare, the EITC helps low and moderate income workers without a special bureaucracy. If there were no EITC, nearly all EITC recipients would still file a tax return (either because they would be required to file, or because they would want to obtain a refund of withheld taxes), and IRS would still have to verify their income and family status. A partially refundable child credit would give workers an additional helping hand without any additional bureaucracy.

- Many workers and families are still struggling to make ends meet. The EITC reduces some of the economic pressure faced by these families, but there is more to do to ensure that full-time workers do not raise their children in poverty.

  - The poverty rate for families with children grew by nearly half from 1979 to 1993. Even after two years of reductions in the poverty rate, 16.3 percent of families with children still lived in poverty in 1995.

  - Between 1979 and 1992, the real earnings of men without high school degrees declined by more than 23 percent. Among male workers with high school degrees, real earnings declined by 17 percent.

  - Payroll taxes, faced by EITC recipients and other low income workers increased five times between 1983 and 1990.

  - In 1996, working families with children could receive the EITC if their income was below $28,495 ($25,078 for workers residing with just one child). In contrast, median income for a family of four in 1996 was about $51,000 (and median income for a family of three was about $43,000). The EITC helps taxpayers with incomes well below the median level, who would benefit substantially from additional tax cuts.

Office of Tax Analysis
June 20, 1997

Mark —
Excellent memo.
Can we flesh out #3+#4
for budget talks, and
#5 for service summit?
Thanks — BR

THE WHITE HOUSE

WASHINGTON

April 15, 1997

TO: BRUCE REED

FROM: MARK MAZUR

cc: CR, EK, Tom, JP, PDL
Pauline, + return

SUBJECT: TAX OPTIONS TO PROMOTE CHILD CARE

In the note Cynthia Rice sent you yesterday, she mentioned that I would develop some information on tax subsidies for child care. What follows is a short description of the existing dependent care tax credit (DCTC), three options to expand this credit, two other options to promote the provision of child care, and the tax credit for FICA taxes that Cynthia described. Note that all revenue estimates presented are just guesses and that Treasury would have to provide current estimates for any proposals that were developed. Please let me know if you wish to discuss these further.

**Dependent Care Tax Credit.** A taxpayer may claim a non-refundable income tax credit for eligible employment-related expenses related to dependent care. Eligible expenses include those for the care of a child under age 13 or a disabled dependent or spouse. Eligible expenses are limited to $2,400 for one dependent or $4,800 for two or more dependents. The credit rate depends on income, with a 30 percent credit rate for those with adjusted gross income below $10,000. The credit rate is reduced with income, so that those with incomes over $28,000 have a 20 percent credit rate.

In 1996, about 6.2 million taxpayers are expected to claim the credit at a total cost of about $2.8 billion (average credit is $445). The 30 percent credit rate is not very meaningful, because those with incomes below $10,000 generally do not have sufficient tax liability to claim the non-refundable credit. But about 1/4 of the total number of households claiming the credit have credit rates over 20 percent (and so have AGI below $28,000).

Those claiming the benefits of the credit are skewed toward the higher end of the income distribution, because (1) higher income households have enough tax liability to benefit fully from the credit; and (2) higher income households tend to spend more on eligible dependent care expenses. About 13 percent of the total tax benefit goes to taxpayers with AGI below $20,000 (about 45 percent of taxpayers), about 46 percent to taxpayers with AGI between $20,000 and $50,000 (about 35 percent of all taxpayers), and about 41 percent to taxpayers with AGI over $50,000 (about 20 percent of all taxpayers).

**Possible Options to Promote Child Care.**

(1) Make the existing Dependent Care Tax Credit (DCTC) refundable -- The existing DCTC is non-refundable, meaning that taxpayers whose income tax liability is less than the credit do not receive the full benefit. Making the DCTC refundable would make it similar to the Earned Income Tax Credit (EITC): taxpayers with low tax liabilities would receive a check from the IRS for the amount by which the credit claimed exceeds their tax liability. This would increase the value of the DCTC to low-income families, which is why child care advocates invariably bring up this proposal. However, the proposal has two drawbacks associated with it. First, making the DCTC refundable would lead to comparisons with the EITC. The comparisons would almost certainly focus on reported error rates, which are around 25-30 percent for the EITC. Congressional Republicans (including Senators Roth and Nickels) have been trying to cut the EITC for years, and proposing a new refundable tax credit may lead to increased attacks on the EITC. Second, refundable tax credits (except the EITC, which is grandfathered under budget rules) generally require annual appropriations for the refundable portion. If taxpayers have to wait until Congress appropriates sufficient funds to cover the refundable portion of a tax credit, the delay could interfere significantly with their planning.

> Treasury estimates the revenue cost of this proposal at around $4 billion for 1998-2002. The Joint Committee on Taxation (JCT) estimated a much smaller amount last year (around 1/2 the size of the Treasury estimate), but it is likely that new JCT estimates would be much closer to Treasury's.

(2) Increase the maximum amount of eligible dependent care expenses to $3,600 for one dependent and $5,400 for two or more dependents (Senator Roberts proposal). This would increase the tax credit that could be claimed by taxpayers who spend more than the current limit on eligible expenses ($2,400 for one dependent and $4,800 for two or more dependents). The proposal would disproportionately benefit those with higher incomes, since that is who spends more than the current law limit on dependent care expenses.

> Treasury has not estimated the revenue cost for this proposal. However, almost any revenue target within the 1998-2002 budget window could be met by choosing a different maximum and/or phasing it in over a number of years. For example, the limits in the Roberts proposal could be achieved by increasing the maximum $300 per year for 4 years ($150 per year for taxpayers with expenses for two or more dependents).

(3) Change the AGI range over which the 30 percent credit rate declines to 20 percent. The phasedown range was set in 1981 and has not been adjusted for inflation. Overall price levels have increased by about 70 percent since then, and a simple increase for inflation would change the credit rate phasedown range to $17,000-$45,000. This proposal would benefit those with low and middle incomes by providing these families with a higher credit rate. (Taxpayers with AGI over $45,000 would continue to claim the same 20 percent credit rate as under current law.) Over half of current DCTC claimants would benefit from this proposal.

Treasury estimates that this proposal would cost about $2 billion over 1998-2002. This revenue cost could be reduced if the changes to the phasedown range occurred in steps. good

(4) Provide a non-refundable tax credit for firms that construct, expand, or renovate child care facilities. The credit rate and maximum annual credit could be chosen to meet a revenue target. Senator Kohl has a similar proposal that would allow firms to claim a tax credit for up to 50 percent of the cost of building, renovating, or <u>operating</u> child care centers, with a credit limit of $150,000 per year. Excluding operating costs from expenses allowable for the credit keeps the revenue cost down and ensures that the credit is targeted toward capital costs that may be difficult for firms to finance.

JCT has estimated the revenue cost of the Kohl proposal at $2.6 billion over 1998-2002 (but note that the Kohl proposal is not available for years after 1999, reducing its overall revenue cost). Limiting the credit to construction, expansion, and renovation expenditures should reduce the revenue cost to well below $1 billion for 1998-2002. very good *

(5) Permit taxpayers to exclude from income amounts of loan forgiven by certain entities. Under current law, loan forgiveness is generally counted as taxable income in the year that the loan is partially or wholly forgiven. This provision, included in the Administration's FY 1998 Budget, would provide an income tax exclusion for income generated by forgiven loans, if the party forgiving the loan is a government or a charitable organization. The intent of this provision is to provide a financial incentive to enter public service professions, by allowing conditional forgiveness of loans without adverse tax consequences. Child care providers appear to fit the broad classes of employment that would qualify for this special tax treatment. The main difficulty in making this proposal work is to find charitable organizations, universities, or governments that are willing to make loans to people who want to become child care providers and are also willing to forgive a portion of the loans as the borrowers enter the designated profession.

The revenue cost of this proposal would be minimal (or even zero) because it appears that only a clarification of the proposal is needed to ensure that child care workers are eligible. Can we do for Service Summit?

(6) Expand the Welfare-to-Work tax credit. The Administration's FY 1998 Budget proposed a 50 percent non-refundable income tax credit for employers who hire long-term welfare recipients. Up to $10,000 in wages would be eligible for the credit, with wages defined broadly to include health insurance, child care, and training expenses. This proposal would provide an additional tax credit for the employer share of FICA taxes that would be paid to long-term welfare recipients. This proposal appears to be duplicative of the tax credit already proposed by the Administration and could easily distract attention from the larger welfare-to-work tax credit. If there is a chance that the Administration will be successful in having its proposed welfare-to-work tax credit enacted, this add-on credit probably should not be pursued.

cc: CRice, EKagan, PAbernathy, PWeinstein

Paul W
Mark Mazur
Tom F.

Can we do this?

-BR

It's kind of an End-of-Big-Govt tax credit.

LISC

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**PAUL S. GROGAN, PRESIDENT**
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FAX: (212) 682-5929

March 25, 1997

Bruce Reed
Domestic Policy Advisor to the
President of the United States
1600 Pennsylvania Avenue, N.W.
Washington, D.C. 20500

Dear Bruce:

Thank you for your meeting with the Enterprise Foundation, Habitat for Humanity, the National NeighborWorks Network, and me March 14.

At that time, we discussed a special opportunity to create additional Low Income Housing Tax Credit authority to rebuild/replace public housing. The Housing Credit would accelerate and inject private market discipline into the redevelopment process.

Enclosed is a one-page proposal developed by LISC and Enterprise for how this might work. We hope to follow up with you soon on this.

Sincerely,

Paul

Paul S. Grogan

Enclosure

March 25, 1997

## Supplemental Low Income Housing Tax Credits for Public Housing Redevelopment/Replacement

The redevelopment of public housing is a national need to which Low Income Housing Tax Credits would bring new investment, private sector discipline, and state participation. However, Housing Credit authority is currently very limited ($1.25 per capita), and would have to be increased significantly to approach meeting a demand that already exceeds availability by three to four times, even without regard to public housing needs. To foster the redevelopment and replacement of distressed public housing, supplemental "Public Housing Credit" authority would be enacted over and above regular Housing Credit authority.

1. The supplemental Public Housing Credits would be authorized at a volume equal to 25 cents per capita nationwide. Public Housing Credits would be distributed among states based on their relative shares of the nation's public housing stock.

2. The states would allocate these Public Housing Credits according to a new subsection of their Qualified Allocation Plans.

   A. Public Housing Credits could only be used to rebuild or replace public housing, not to add to the net stock of public housing.

   B. Preference among projects for state allocations would be based on: (1) relative redevelopment needs; and (2) the extent to which the housing will be developed as part of a comprehensive redevelopment strategy serving a range of incomes and involving residents of the public housing and surrounding communities.

   C. Unused Public Housing Credits could be carried over for one year and, if still not used, would be returned to a national pool for redistribution to those states that have used at least 90% of their available Public Housing Credits. This national pool redistribution would be redistributed based on the eligible states' relative share of the nation's public housing stock.

3. Below-market federal loans could be used without reducing the amount of Public Housing Credits available to a project.

4. Redeveloped/replaced public housing would have to meet regular Housing Credit tenant income and rent requirements for at least 30 years. All other regular Housing Credit requirements would also apply.

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File: Targeted Jobs Tax Credit ~~WR To Do~~ ~~(Jeremy)~~

Jeremy – You've talked to these guys, haven't you? BR

December 9, 1993

Bruce Reed
Deputy Assistant To The President
For Domestic Policy
The White House
1600 Pensylvania Ave, NW
Washington, DC 20500

BR – we did meet with them. Joe worked a little on the campaign on the W.H. This main issue is TJTC lobbying –JSA.

Dear Mr. Reed:

As a member of the Working Group on Welfare Reform, I thought that you might find this news clip interesting. As part of their plan to reform welfare, the State of Virginia is offering incentives to employers to hire people receiving AFDC. In addition to the state subsidy the businesses involved are taking "a federal tax credit". This is just another example of the Targeted Jobs Tax Credit (TJTC) assisting in the placement of the structurally unemployed.

At NEON, we are pleased that states like Virginia and Wisconsin are taking the initiative to reform welfare and assist those who face barriers to mainstream employment. It is through federal programs such as the Targeted Jobs Tax Credit that the structurally unemployed will be able to break free of dependence on the government. We believe that programs like TJTC, as part of the reform of the welfare system will be helpful in getting people off of welfare and into the workforce.

Sincerely,

Joseph E. Dennison

Joseph E. Dennison
Executive Director

enclosure

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# Alexandria Hospital Takes Lead

## 5 Jobs Start Va. Program to Move Mothers From Welfare to Work

By Steve Bates,
Washington Post Staff Writer

Alexandria Hospital has agreed to provide the first five jobs in an experimental program that could take as many as 1,000 Virginians off welfare by giving them full-time work, Gov. L. Douglas Wilder announced yesterday.

Wilder challenged other Virginia businesses to provide jobs to single mothers and allow them to break free of poverty and dependence on the government. The salaries will range from $15,000 to $18,000 a year.

"We want all of Virginia's children to grow up in families where having a decent job is the norm, not the exception," the governor said at a news conference in Alexandria. "Many of our social problems—school failure, crime and poverty—are reduced when people have jobs."

The initiative, approved last month by the U.S. Department of Health and Human Services, places Virginia among the growing number of states that are testing methods to curb welfare costs and joblessness. Wisconsin officials hope to eliminate existing welfare programs this decade, and President Clinton has pledged to push a similar effort nationwide.

Wilder, a Democrat, said he hopes that Republican Gov.-elect George F. Allen will continue the four-year project when he takes office next month. However, Allen spokesman Ken Stroupe said the governor-elect is not committed to do so.

Allen "is going to be taking a close look at every aspect" of human services, Stroupe said. "I'm not going to comment on any specifics of Wilder's plan." Allen campaigned on a platform of requiring most welfare recipients to work and eliminating their benefits after two years.

State officials said the program may not reduce the number of people on welfare because of the impact of the recession. About 74,000 Virginia families receive Aid to Families With Dependent Children. If the program is successful, officials said, they will ask the federal government to authorize its expansion.

The program, which will be voluntary for welfare recipients, will begin immediately. Unlike many existing job training programs, officials said, this one will train people for whom jobs already have been identified. Participants must be paid at least $7 an hour.

Alexandria Hospital officials said the five jobs they are providing will be clerical positions in admissions, nursing and a clinic. Lt. Gov. Donald S. Beyer Jr. said yesterday that his Falls Church Volvo dealership also will participate in the program, and Wilder said he expects some of the state's "leading corporations, Fortune 500 companies," to offer jobs.

"I think that within 100 days we'll have 1,000 jobs available," said Howard M. Cullum, Wilder's secretary of health and human services.

Participating businesses will gain a federal tax credit, and the state will use some of its welfare saving to subsidize 20 percent of each worker's salary for the first year of employment and 10 percent in the second year. The program is open only to women who have received Aid to Families With Dependent Children for at least two years, whose children are school-aged, and who have a high school diploma or the equivalent.

THE WHITE HOUSE

WASHINGTON

June 14, 1994

Edmund S. Phelps
Russell Sage Foundation
112 East 64th Street
New York, New York 10021

Dear Dr. Phelps:

Thank you for your letter enclosing a copy of your working paper on a Program on Low-Wage-Employment Tax Credits. I find your research at the Russell Sage Foundation interesting.

I appreciate your taking the time to share your work with me.

Sincerely,

Bruce Reed
Deputy Assistant to the President
for Domestic Policy

**RUSSELL SAGE FOUNDATION**
112 East 64th Street
New York, New York 10021

EDMUND S. PHELPS
Visiting Scholar

Mr Bruce Reed
Deputy Assistant to the President
for Domestic Policy
The White House
Old Executive Office Building, Rm 216
Washington, DC 20500

Dear Mr Reed:

It occurred to me that you might find refreshing a different voice on the subject of 'welfare' and jobs.

So I enclose the working paper coming out of my work in this area during my year here at Russell Sage. (The framework for the analysis was developed in my recent book *Structural Slumps*, though the paper goes farther in bringing in some of the effects on wages, employment, etc. of worker disadvantage with respect to education or potential.)

Of course, I would welcome any constructive comments you may have.

Sincerely,

Edmund Phelps

Encl. RSF #55

FAX: (212) 371-476

# RUSSELL SAGE FOUNDATION

Working Paper #55

## A Program of Low-Wage-Employment Tax Credits
### To Pull Up the Employment and Wage Rates of the Disadvantaged

Edmund S. Phelps

RUSSELL SAGE FOUNDATION
[illegible]

# RUSSELL SAGE FOUNDATION

Working Paper #55

## A Program of Low-Wage-Employment Tax Credits
### To Pull Up the Employment and Wage Rates of the Disadvantaged

Edmund S. Phelps

May, 1994

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DRAFT

Cynthia FYI

[CM: c-return a copy]

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.

SECRETARY OF THE TREASURY

MEMORANDUM FOR ERSKINE BOWLES
CHIEF OF STAFF
THE WHITE HOUSE

FROM: SECRETARY ROBERT E. RUBIN

SUBJECT: Structure and Agenda for Tax Task Force

We suggest that the Administration's position on the structure and agenda for the Tax Task Force should include the following main points:

1. **Membership.** We understand the Task Force will include approximately 12 representatives (equal numbers from Majority and Minority) from the House and 8-10 from the Senate (similarly equally from Majority and Minority). We suggest the Administration's 3-5 representatives should be: Deputy Secretary Summers, Acting Assistant Secretary Lubick, and Assistant Secretary Robertson from Treasury, and Deputy Director Lew and Associate Director Minarik from OMB.

2. **Agenda.** The Task Force members should seek to reach prompt agreement on its agenda and objectives. We suggest the agenda should begin with an item-by-item review of the major tax proposals which have been offered by the Administration, Majority Leader Lott, and Minority Leaders Daschle and Gephardt. (For this purpose, an initial draft "side-by-side" comparison of the principal proposals is attached.) The objectives of this exercise will be to familiarize the Task Force members with the various tax proposals, determine areas of broad agreement, and identify areas of disagreement, for the purpose of facilitating--not supplanting--the normal committee process.

3. **Timing.** We estimate the Task Force process may take approximately two to three weeks. Again, taking into account the Task Force's work, the normal committee process should go forward in the usual way.

Attachment

cc: Larry Summers
Don Lubick
Linda Robertson

Comparison of Tax Incentives in Major Proposals for FY1998
Updated: February 24, 1997 5:00PM

| Administration Proposals | Senate Democratic Leadership Package (Daschle)** | Senate Republican Leadership Package (Lott) | |
|---|---|---|---|
| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 1. **Tax credit for dependent children***: Nonrefundable credit for each dependent child under age 13. Fully phased-in amount (by 2000) is $500, phased-out for filers with AGI between $60,000-$75,000. Credit is stacked ahead of the EITC.<br>5yr.: ($46.7b) 10yr.: ($98.0b)* | No Provision | No Provision | Nonrefundable credit of $500 for each child under age 18. Phaseout, beginning at AGI of $75,000 ($110,000 for joint returns), of $25 of credit for each $1,000 of additional AGI. Credit is not indexed for inflation. Credit is stacked after the EITC.<br>5 yr: ($109.0b) 10 yr: (199.0b)*** |
| 2. **HOPE Scholarship Plan and tuition tax deduction***<br><br>HOPE Plan: Nonrefundable credits of up to $1,500 per year per student for the first two years of post-secondary education. Students must be at least half-time status. Taxpayer claims the lesser of maximum credit or tuition and required fees actually paid, i.e., not covered by any scholarship or non-federal grant. Pell or other federal grants reduce the allowable credit. A "B-" average is required to be eligible for the second year credit; drug felons are ineligible. The credit phases out for taxpayers with modified AGI of $80,000 to $100,000 ($50,000 - $70,000 if single); phase-out thresholds and the maximum credits are indexed. Effective for payments made on or after 1/1/97, for education commencing on or after 7/1/97. Tuition tax deduction of up to $5,000 per year ($10,000 after 1998) per taxpayer. For any one student either credit or deduction can be used for tuition and required fees not covered by student aid with the HOPE Plan's AGI phase-out ranges.<br><br>Also, expand income exclusion for forgiveness of certain student loans.<br><br>5 yr.: ($36.2b) 10 yr.: ($87.8b) | Similar except credit is refundable. B average rule based on high school record. $1,500 credit for full-time, $750 credit for part-time half-time students. Effective for taxable years beginning after 1997. | No Provision<br><br>(Please refer to 19.-22. for continued education incentives) | No Provision |

| Administration Proposals | Senate Democratic Leadership Package (Daschle)** | Senate Republican Leadership Package (Lott) | |
|---|---|---|---|
| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 3. **IRA Provisions***: Double (by 2000) current law income thresholds and phase-out ranges for deductible IRA contributions. Index thresholds and contributions for inflation. Create new back-loaded IRAs subject to income limits, and permit conversion of deductible IRA amounts into back-loaded IRAs with income inclusion (spread over 4 years for pre-1999 conversions). Add exceptions to 10% early withdrawal tax for qualified post-secondary education expenses, first home purchase and long-term unemployment. Expansion of penalty-free withdrawals for medical costs. Expressly permit IRAs to invest in qualified State tuition program instruments. Income tax-free and penalty-free withdrawals from back-loaded IRAs after 5 years. Penalty-free withdrawals for special purposes permitted within 5 year period. (No special provisions made to eliminate income limits for a spouse of an active participant in an employer-sponsored retirement plan.)<br>5 yr.: ($5.5b) 10 yr.: ($20.9b) | **IRA Provisions**: Raise annual contribution limits for single and joint filers. Permit spouse of active participant in an employer-sponsored retirement plan to make a deductible IRA contribution without regard to the income limits. Index thresholds and contributions for inflation. Penalty-free withdrawals for education and home purchase. Expansion of penalty-free withdrawals for medical costs. (Does not create back-loaded IRAs).<br><br>*Require employers to allow payroll deduction contributions to IRA of up to $2,000.* The contributions would go to an IRA maintained by government-selected contractor that would offer a limited choice of investments.<br><br>*Nonrefundable tax credit for IRA contributions bh or on behalf of low- and moderate-income individuals (with AGI of $30,000 or less).*<br><br>Allow deferral of up to $400,000 of capital gains when proceeds from farm sales go to IRA.<br><br>**Pension Provisions**: Modifies rules for 1996's pension simplification to include provisions in Administration's proposal requiring 1 percent automatic employer contribution for employees participating in small business plan and in plans using the 401(k) safe harbor, and adding multiemployer provisions. | **See Education Investment Accounts (21.).** | **IRA Provisions**: Increase income thresholds and phase-out ranges for joint and single filers. *After 2000, repeal income limits for deductible IRA contributions.* (Prior to repeal, permit spouse of active participants in employer-sponsored retirement plans to make a deductible IRA contribution without regard to the income thresholds). Allow withdrawals for special purposes (qualified business start-up expenses, long-term unemployment and education expenses) to be *income tax free* and exempt from the 10% early withdrawal tax. Create new back-loaded IRAs without income limits, and permit conversion of deductible IRA amounts into back-loaded IRAs with income inclusion (spread over 4 years for pre-1999 conversions). Allow withdrawal of contributions from back-loaded IRA at any time without income tax or 10% early withdrawal tax, allow withdrawal of earnings to be income tax free and exempt from 10% early withdrawal tax if after age 59 1/2 (and after 5 years following initial contribution), death, disability or if for a special purpose.<br>5yr: ($32.7b) 10 yr.: ($112.7b) |

| Administration Proposals | Senate Democratic Leadership Package (Daschle)** | Senate Republican Leadership Package (Lott) | |
|---|---|---|---|
| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| | **Pension Provisions (cont.):** A number of proposals were included at the request of other members (e.g., permanent exemption of state/local government pension plans from non-discrimination rules, faster vesting of 401(k) matching contributions, limits on plan investment in employer stock, new rules on spousal benefits and benefits in divorce, new transfer rules, and prohibition on pension-secured credit cards). | | |
| 4. **Welfare-to-Work Tax Initiative:** Employers would be permitted a 50 percent tax credit on the first $10,000 of wages paid to certain long-term welfare recipients and could claim this credit for up to two years. Wages would include amounts paid by the employer for employer-provided educational assistance, health care, and dependent care assistance. This credit would be available through September 30, 2000. The present WOTC would be expanded to include as an eligible group adults 18-50 years old who are subject to the time limits for Food Stamps under the Administration's legislative proposal to amend the Welfare Act of 1996. 5yr.: ($0.6b) 10 yr.: ($0.6b) | No Provision | No Provision | No Provision |

| Administration Proposals | Senate Democratic Leadership Package (Daschle)** | Senate Republican Leadership Package (Lott) | |
|---|---|---|---|
| | | **Affordable College Act (S.1)** | **American Family Tax Relief Act (S.2)** |
| 5. **Capital Gains Provisions** | | | |
| Exclusion on sale of principal residence: The current rollover provision and one-time exclusion of up to $125,000 of gains on residences would be replaced by an exclusion of up to $500,000 ($250,000 for non-joint filers). The home would have to have been owned and occupied as a principal residence for at least two years during the five years prior to the sale. The exclusion would be available only once every two years. Taxpayers forced to move without meeting these requirements (for example, because of medical reasons or a change in place of employment) would be eligible for a pro-rated exclusion. The effective date would be January 1, 1997, with transition relief.<br>5 yr.: ($1.5b) 10 yr.: ($2.4b) | Provision similar to Administration proposal but includes extending the exclusion to tenant-stock holding in cooperative housing corporations.<br><br>Rollover provision allowing deferral of sale of a qualified small business or partnership investment if proceeds reinvested in another such investment within six months. Increase asset size limit for small business exclusion to $100 million and liberalize other provisions. Increase limit on deduction of losses on the sale of small business stock to $300,000.<br><br>**Note: Senator Ford's sliding scale capital gains proposal:** For assets held more than one year, additional 2 percent decrease in current 28 percent rate for each year the asset is held; for assets held more than eight years, the rate is 14 percent. | No Provision | 50 percent exclusion of net long-term gains for individuals, effective 1/1/97. Collectibles ineligible for exclusion but retain maximum rate of 28%. Otherwise, maximum rate repealed. Index basis of stock and tangible property for assets purchased after 12/31/96 and held three years. Increase asset size limit for small business exclusion to $100 million and liberalize/other provisions. Provides alternative rate of 28% for corporations. Capital losses on residences deductible.<br>5 yr: ($33.1b) 10 yr.: ($129.3b) |

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|---|---|---|---|
| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 6. **Establish D.C. Tax Incentive Program:**<br>*D.C. jobs credit:* 40 percent subsidy to businesses in D.C. on first $10,000 of eligible wages (including employer-provided health care, dependent care, educational assistance) to WOTC-eligible employees or any D.C. resident living in a census tract with poverty rate of 15 percent or more. Employee wages must be less than $28,500.<br><br>*Additional $20,000 of Sec. 179 expensing*: Businesses must be located within census tracts that have a poverty rate of at least 15 percent to be eligible.<br><br>*Employment/training grants for tax-exempt organizations:* Would be available to organizations that hire economically disadvantaged D.C. residents or provide job placement assistance to welfare recipients.<br><br>*Allocated tax credits to lenders to finance buildings and equipment and to investors for equity investments*<br><br>*Tax-exempt bond authority*: Expand enterprise zone facility bonds by making them available to qualified D.C. businesses within census tracts with at least 15 percent poverty rate. Compared to EZ facility bonds, businesses may count any resident of D.C. to comply with 35 percent residency requirements, $3 million per borrower cap would be raised to $15 million, and a broader range of business property can be financed.<br>5 yr: ($0.3b) 10 yr.: ($0.3b) | No Provision | No Provision | No Provision |

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|---|---|---|---|
| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 7. **Small business estate tax relief**: Addresses liquidity problem of small business owners by increasing to \$2.5m the amount eligible for special interest rate on deferred estate taxes. Expands the types of business interests eligible to defer estate taxes, and makes other simplifying changes.<br>5 yr.: (\$0.7b) 10 yr: (\$1.5b) | Estate tax exemption for first \$900,000 of value of a "qualified family-owned business interests" that exceed 50 percent of the value of decedent's estate. This exemption is in addition to the unified credit, which exempts \$600,000 of property from the estate or gift tax. Also, liberalize current law regarding special use valuations for estate tax purposes | No Provision | Increase unified estate and gift tax credit to \$1m. by 2004. Family-owned business exclusion up to \$1.5m where value exceeds 50 percent of decedent's estate. Exclusion is in addition to unified credit. Additional exclusion for 50 percent of value in excess of \$1.5m. for qualifying estates. 20 year installment payment plan for certain businesses. No interest on portion of estate tax (on the first \$1m. in value) extended under Sec. 6166.<br>5 yr: (\$18.6b) 10 yr: (\$66.9b) |
| 8. **Expansion of Empowerment Zone/Enterprise Community (EZ/EC) program and Brownfields clean-up tax incentives**: *EZ/EC expansion*: (i) Second-round designation of 20 new EZs and 80 new ECs; (ii) designate 2 additional first-round EZs; (iii) liberalize current EZ/EC tax-exempt bond provisions and qualifying business definition.<br><br>Second-round tax incentives -- Qualifying businesses in EZs eligible for tax-exempt bond financing outside the current-law State volume cap, increased §179 expensing, and brownfield clean-up incentive for additional acreage. Qualifying businesses in ECs eligible for current-law EZ/EC tax-exempt bonds and brownfield clean-up incentive.<br><br>*Brownfield Clean-up Incentive**: Current deduction for expenses incurred to clean-up brownfields in targeted geographic areas (first- and second-round EZs/ECs; census tracts with 20% or higher poverty and contiguous industrial/commercial areas; 76 previously announced EPA Brownfield pilot projects).<br>5 yr.: (\$2.3b) 10 yr.: (\$3.8b) | No Provision | No Provision | No Provision |

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| | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 9. **Tax Credit for Equity Investment in Community Development Financial Institution (CDFI):** A tax credit (up to 25 percent) for equity investments in qualified CDFIs. Capped amount of credits ($100 million) to be allocated by the CDFI Fund (effective date 1/1/98).<br>5 yr.: ($0.03b) 10 yr.: ($0.09b) | No Provision | No Provision | No Provision |
| 10. **Toll Statute of Limitations for Incapacitated Taxpayers:**<br>5 yr.: ($0.06b) 10 yr: ($0.7b) | No Provision | No Provision | No Provision |
| 11. **Allow Foreign Sales Corporation (FSC) Benefits for Computer Software Licenses:**<br>5 yr.:($0.6b) 10 yr.: ($1.5b) | No Provision | No Provision | No Provision |
| 12. **Extension of Sec. 127 through December 31, 2000:** The Administration proposed extension through 12/31/2000 of the exclusion from employees' taxable income of up to $5,250 per year of educational expenses paid for by their employer and reinstatement of the exclusion for graduate courses. Also, reinstate retroactively the exclusion for graduate education. The Administration also proposed a new 10 percent training credit for small businesses.<br>5 yr.: ($2.4b) 10 yr.: ($2.4b) | The exclusion would be made permanent. Directs the Dept. of Labor, in consultation with Treasury to conduct a study of this provision. | The exclusion would be made permanent and the provision limiting the exclusion to undergraduate courses would be repealed retroactively.<br>5 yr.: ($3.5b) 10 yr.: ($8.0b)*** | No Provision |
| 13. **Extend for One Year the R&E Tax Credit**<br>5 yr.: ($2.1b) 10 yr.: ($2.2b) | No Provision | No Provision | No Provision |
| 14. **Extend for One Year the Orphan Drug Tax Credit**<br>5 yr.: ($0.05b) 10 yr.: ($0.05b) | No Provision | No Provision | No Provision |
| 15. **Extend WOTC for One Year**<br>5 yr.: ($0.4b) 10 yr.: ($0.4b) | No Provision | No Provision | No Provision |
| 16. **Extend for One Year Deduction for Contributions of Appreciated Stock to Private Foundations:**<br>5 yr.: ($0.07b) 10 yr.: ($0.07b) | No Provision | No Provision | No Provision |

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| | | | Affordable College Act (S.1) | American Family Tax Relief Act (S.2) |
| 17. | **Modify Phase-out of Puerto Rico Economic-Activity Tax Credit** 5 yr.: ($0.4b) 10 yr.: ($3.9b) | No Provision | No Provision | No Provision |
| 18. | No Provision | **The Children's Health Coverage Act**: Refundable credit covering 90% of child's health insurance premium, phased-out for families with income above $75,000. Credit available for children ineligible for Medicaid or employer provided plans. | No Provision | No Provision |
| 19. | No Provision | **Deduction for Student Loan Interest**: Above the line deduction for interest paid after 12/31/97 for tax payer and spouse. Phase-outs: $70k single filers, $100k joint. | **Deduction for Student Loan Interest**: Same except $2,500 annual limit, including interest on loans for dependent's education. Effective after 1996. Phase-outs: $45k-$65k single filers, $65k-$85k joint. 5yr.: ($0.7b) 10 yr.: ($1.9b) | No Provision |
| 20. | No Provision | No Provision | **Tax-free Withdrawals from State Tuition Plans**: No tax would be owed on any portion of a withdrawal made from a qualified state tuition plan for qualified higher education expenses, which would include tuition, fees, room, board, books. Effective after 1996. 5 yr.: ($0.6b) 10 yr.: ($1.6b) | No Provision |

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| | | **Affordable College Act (S.1)** | **American Family Tax Relief Act (S.2)** |
| 21. No Provision | No Provision | **Bob Dole Education Investment Accounts:** Nondeductible contributions of up to $1,000 per year per child under the age of 18. Distributions used for higher education expenses excluded from income. 10 percent penalty for other distributions. Effective after 1996<br>5 yr.: ($1.8b) 10 yr.: ($5.6b) | No Provision |
| 22. No Provision | No Provision | **Exclusion of Federal Work Study Payments:** Payments excluded from gross income after 1996.<br>5 yr.: ($0.4b) 10 yr.: (1.0) | No Provision |
| 23. No Provision | **Creation of Performance Stock Options:** Applicable where over 50 percent of options are available to nonhighly compensated employees. Option price must be less than fair market value at time of grant. No income is recognized on exercise if shares are held for one year and there is a 50 percent exclusion of capital gains on sale of stock. | No Provision | No Provision |