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Major Tax Issues in the 109th Congress

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December 14, 2006

Abstract. Various tax issues have been considered by the 109th Congress. Among the most prominent have been the estate tax; the alternative minimum tax; tax provisions related to Hurricane Katrina; tax shelters; tax-related aspects of pensions, health care, and charitable giving; and whether to extend the tax cuts enacted in 2001 that are scheduled to expire in 2010. In addition, the question of whether to adopt fundamental tax reform has been debated. Specific tax-related legislative activity has focused on budget reconciliation. The fiscal year (FY) 2006 budget resolution (H.Con.Res. 95), approved in April 2005, called for net tax cuts totaling \$105.7 billion over five years. Tax cuts totaling \$70 billion were included in reconciliation instructions.

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CRS Report for Congress

Major Tax Issues in the 109th Congress

Updated December 14, 2006

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**Prepared for Members and
Committees of Congress**

Major Tax Issues in the 109th Congress

Summary

Various tax issues have been considered by the 109th Congress. Among the most prominent have been the estate tax; the alternative minimum tax; tax provisions related to Hurricane Katrina; tax shelters; tax-related aspects of pensions, health care, and charitable giving; and whether to extend the tax cuts enacted in 2001 that are scheduled to expire in 2010. In addition, the question of whether to adopt fundamental tax reform has been debated.

Specific tax-related legislative activity has focused on budget reconciliation. The fiscal year (FY) 2006 budget resolution (H.Con.Res. 95), approved in April 2005, called for net tax cuts totaling \$105.7 billion over five years. Tax cuts totaling \$70 billion were included in reconciliation instructions.

In late 2005, the Senate and House approved separate tax reconciliation bills. Prominent in both bills was the extension of a number of temporary tax-reducing provisions scheduled to expire over the next several years (“extenders”). The bills differed, however, in the precise list of provisions that would be extended and in the length of several extensions. Prominent extensions in both plans included the research and experimentation tax credit and the “expensing” benefit for small business investment. Items that differed were extension of the increased alternative minimum tax (AMT) exemption (present in the Senate bill, but not the House measure) and reduced rates for dividends and capital gains (contained in the House bill, but not the Senate plan). On May 9, 2006, a conference committee approved a reconciliation tax bill (H.R. 4297; enacted as P.L. 109-222) that extended both AMT relief and dividend and capital gains tax cuts, as well as an increased expensing benefit. The bulk of the remaining extensions, however, were not in the agreement.

The 109th Congress resumed consideration of the extenders in its post-election session in early December. On December 9, the Senate approved an extenders bill (H.R. 6111) that had been approved by the House on December 8. In general, the bill extends the temporary provisions for an additional two years (through 2007). The revenue cost of the extenders is estimated at \$38.1 billion over five years and \$45.1 over 10 years. The measure also contains non-tax items related to Medicare and trade.

This report will be updated as tax-related legislative activity occurs.

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Major Tax Issues in the 109th Congress

Congress debated a number of tax topics in 2005, although major tax legislation was not enacted. One topic was fundamental tax reform — the Administration indicated that consideration of a basic restructuring of the tax system is one of its chief domestic policy priorities for its second term. Other topics receiving congressional attention were revision of the alternative minimum tax and extension of tax cuts that are scheduled to expire. Each of these topics continued to receive congressional attention in 2006.

As 2005 drew to a close, congressional attention turned to budget reconciliation. In April, 2005, Congress approved an FY2006 budget (H.Con.Res. 95) calling for \$105.7 billion of tax cuts over five years and \$17.8 billion of cuts in FY2006. \$70 billion of the five-year tax cuts were included in reconciliation instructions and \$11 billion were included for FY2006. The instructions are important because Senate rules provide that tax cuts not included in reconciliation may be subject to a point of order and require a supermajority (60 votes) for passage.

In November, the House Ways and Means Committee and the Senate Finance Committee passed their own versions of tax reconciliation legislation as H.R. 4297 and S. 2020, respectively. (In February, 2006, the Senate approved H.R. 4297 after amending it by replacing the contents of the House-passed bill with those of S. 2020.) An important part of both the House and Senate bills was the extension of various expiring tax provisions, although the plans differed in the particulars of their respective extensions. A prominent difference between the bills was the presence in the Senate bill (but not the House bill) of an extension for an increased minimum tax exemption and the presence in the House bill (but not the Senate's) of an extension of reduced rates for dividends and capital gains. Also, the Senate proposal contained disaster-related tax cuts, measures aimed at charitable contributions, and a set of revenue-raising items not contained in the House bill. On May 9, 2006, a conference committee approved a compromise version of H.R. 4297 (see the section below on taxes and budget reconciliation for details), and the bill was enacted as the Tax Increase Prevention and Reconciliation Act (TIPRA; P.L. 109-222).

On July 29, the House passed a minimum wage bill (H.R. 5970) that also included provisions that would increase the estate tax exemption and reduce estate tax rates in 2010 and beyond, and that would extend many of the temporary provisions that were ultimately not extended by reconciliation legislation. Congress did not pass H.R. 5970 before the November elections: on August 3 the Senate did not approve a cloture motion that would have led to the bill's consideration.

The 109th Congress resumed consideration of the extenders in its post-election session in early December. On December 9, the Senate approved an extenders bill (H.R. 6111) that had been approved by the House on December 8. In general, the bill

extends the temporary provisions for an additional two years (through 2007). The revenue cost of the extenders is estimated at \$38.1 billion over five years and \$45.1 over 10 years. The measure also contains non-tax items related to Medicare and trade.

The Economic Context

Tax policy is frequently considered by policymakers as a tool for boosting economic performance in various ways, and the likely economic effects of tax policy are often hotly debated. For example, if the economy is sluggish and unemployment is high, tax cuts are sometimes recommended by some as a fiscal stimulus to boost demand. Or, in the longer term, tax cuts for saving and investment are championed by some as a means of boosting long-term economic growth. At the same time, taxes can also affect long-run growth through the federal budget — along with spending, tax revenues determine the size of the budget surplus or deficit. And the size and nature of the budget balance can affect long-run growth by determining the extent to which government borrowing needs compete for capital with private investment, thus damping long-run growth.

Taxes also have a distributional effect. That is, the rate and manner in which taxes apply to different activities, groups, and income levels can alter the distribution of income within the economy. For example, the taxes can affect the distribution of income across income levels (can affect “vertical equity”) by applying at different rates to different income levels. And taxes can affect “horizontal equity” by applying differently to different types of income.

With these broad economic effects in mind, a discussion of three aspects of the economy follows. First is a look at the current state of the economy, both in terms of long-run growth and the short-run state of the business cycle. Next is a review of the current, recent, and expected future state of the federal budget. Third is a brief review of the level and distribution of the tax burden.

The State of the Economy

In 2006, the economy continued its expansion and recovery from the recession that reached its trough in November 2001; the economy has now registered positive real economic growth for 18 consecutive quarters. Real growth was relatively sluggish during the first quarters of the recovery, but began to pick up momentum in mid-2003. In 2001 (the first full year of the recovery), real gross domestic product (GDP) grew at a 0.8% rate, followed by 1.6% in 2002, 2.5% in 2003, 3.9% in 2004, and 3.2% in 2005. In 2006, the annualized growth rate was 5.6% in the first quarter, but then moderated to 2.6% in the second quarter and 1.6% in the third. Federal Reserve Chairman Ben Bernanke has characterized the economy as being in a “transition” phase — moving from rapid growth fueled by the absorption of resources underutilized in the last recession to a more moderate growth rate that depends on growth in the economy’s basic productive capacity.¹

¹ Ben S. Bernanke, Testimony before the Committee on Banking, Housing, and Urban (continued...)

The outlook for 2007 by most prognosticators — including the Congressional Budget Office (CBO), the Office of Management and Budget (OMB), and private sector forecasters — is for real growth in the 3% to 3.5% range. Still, the picture has its less sanguine side, especially in the area of employment. The recovery of payroll employment does not measure up to that recorded in past expansions: the unemployment rate is currently 4.6% (for September, 2006), compared to the low of 3.8% achieved in the last expansion.²

Although the current economic context of tax policy is thus one of growth, a principal focus of the tax policy debate in recent years has been the efficacy of tax cuts as an economic stimulus. The tax cuts of 2001, 2002, and 2003 were enacted, in part, as a means of stimulating a still-sluggish economy, and although the recession has ended and economic growth has picked up momentum, the debate over the merits of tax cuts as economic stimulus continues to resonate. For example, one subject of current debate is the extent to which tax cuts are responsible for the economy's rebound and the extent to which factors such as monetary policy are responsible.³ It is thus informative to review the main outlines of economic performance over the past few years.

The economic boom of the 1990s lasted nine consecutive years, but by late 2000, the economy began to show signs of weakness. President-elect Bush had called for a tax cut during the election campaign for philosophical reasons and to spur long-term growth, but as 2000 came to an end, he added that a tax cut would also be advisable as a means of providing a near-term fiscal stimulus to the sluggish economy. The tax cut he proposed in January 2001 ultimately became the basis for the large reduction enacted as EGTRRA in June 2001.

As 2001 progressed, there were increasing signs of economic weakness, and in November, the National Bureau of Economic Research (NBER; the organization that tracks business cycles) determined that a recession had begun in March of that year. Economic data now show that the economy contracted during the first and third quarters of 2001 before registering positive growth again in the fourth quarter of that year. The recession ended in November 2001, having lasted eight months. The recession was of about average severity and duration for economic recessions of the post-World War II era.⁴

¹ (...continued)

Affairs, U.S. Senate, July 19, 2006. Posted on the Federal Reserve Board's website, at [<http://www.federalreserve.gov/boarddocs/hh/2006/july/testimony.htm>], visited Nov. 15, 2006.

² For additional information about the state of the economy, see CRS Report RL30329, *Current Economic Conditions and Selected Forecasts*, by Gail E. Makinen.

³ For an analysis, see CRS Report RL32502, *What Effects Have the Recent Tax Cuts Had on the Economy?*, by Marc Labonte.

⁴ CRS Report RL31237, *The 2001 Economic Recession: How Long, How Deep, and How Different from the Past?*, by Marc Labonte and Gail Makinen.

Following the recession, the economy registered positive growth in all four quarters of 2002 and 2003, but still exhibited signs of sluggishness. Business investment spending was weak and employment continued to decline. Further, the pattern of growth was uneven, leading observers to characterize the economy's performance since the end of the recession as "choppy" and "sub-par." Several factors were thought to be placing a drag on the economy: a long adjustment in capital spending; the "fallout" from revelations of corporate malfeasance; declines in the stock market; and increased "geopolitical risks," including the possibility of war in Iraq. Investment spending picked up in 2004 and 2005, led by the residential sector.

Economic growth was strong from the second half of 2003 onward. The performance is qualified, however, by the labor market. Payroll employment has increased, but at slower rates than in the 1990s. The unemployment rate has gradually declined since 2003, and is now lower than it was during all but the last three years of the 1990s expansion.

This section was co-authored by Marc Labonte, Specialist in Macroeconomics, Government and Finance Division. For further reading, see CRS Report RL30329, *Current Economic Conditions and Selected Forecasts*, by Gail Makinen.

The Federal Budget

According to the Congressional Budget Office (CBO), the federal budget is projected to register a deficit equal to 2.0% of GDP in FY2006.⁵ This marks the second consecutive year the deficit has fallen relative to the size of the economy; the deficit was 2.6% of GDP in FY2005 after reaching a level of 3.6% of GDP in FY2004. The expected deficit in FY2006 will mark the fifth year in a row the budget has registered a deficit after being in surplus for the four-year period FY1998-FY2001. However, CBO's most recent budget report (released in August, 2006) also projects a continued gradual decline in the deficit as percentage of GDP, shrinking to a position of near-balance (a deficit of 0.3% of GDP) by 2012. As described below, however, this projection assumes that current policies remain in place, and if that assumption is dropped, the outlook changes — an important consideration given congressional interest in extending or making permanent the 2001 and 2003 tax cuts, which are scheduled to expire at the end of calendar year 2010.

A broader historical perspective shows several reversals in the federal budget situation in recent years. The budget was in deficit throughout the 1970s, 1980s, and most of the 1990s before registering a surplus in FY1998, a result of both the booming economy and legislation designed to enforce budget discipline. The budget surplus grew for the next two years, reaching a peak of 2.4% of GDP in FY2000 before declining in FY2001 and moving into deficit in FY2002. The difference between the surplus in FY2000 and the deficit for FY2006 is projected to amount to 4.4% of GDP. The budget data indicate that the change was a result of both a growth in outlays and a decline in revenues. The decline in revenues was more pronounced,

⁵ U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update* (Washington: GPO, 2006), p. x.

though not by a wide margin. Revenues are projected to have declined from 20.9% of GDP in FY2000 to 18.3% in FY2006, a drop of 2.6 percentage points. Outlays are estimated to have increased by only 1.9 percentage points over the same period. The decline in revenues had two sources: the recession of 2001 and subsequent sluggish economic growth, and enacted tax cuts.

The decline in the relative size of the projected deficit in FY2006 resulted from an increase in revenues; receipts are estimated to have increased by 0.8% of GDP (to 18.3%) while outlays grew by 0.2% of GDP (to 20.3%). The expected increase in total receipts in FY2006 primarily reflects increases in individual and corporate income tax receipts.

The outlook, however, may change. As described elsewhere in this report, the tax cuts enacted in 2001 by EGTRRA expire at the end of calendar year 2010; parts of JGTRRA's acceleration of EGTRRA (as extended by legislation in 2004) expire at various times before 2010. Extending the tax cuts would have a substantial impact on the budget, particularly after 2010. In addition, the application of the alternative minimum tax (AMT) to an increasing number of taxpayers may exert pressure to increase the AMT's exemption amount. CBO's August *Budget and Economic Outlook: An Update* estimated that extending all tax provisions scheduled to expire between 2006 and 2016 (except those related to the AMT) would reduce federal revenue by \$1.9 trillion over fiscal years 2007-2016. When combined with their implied impact on federal debt service (i.e., interest payments), the revenue reductions would more than double the projected baseline deficit over the period.⁶

The longer-term budget situation is a concern to many policymakers, chiefly because of the combination of rising health care costs and demographic pressures posed by an aging population that will begin with the retirement of the "baby boom" generation. Under current law, spending on Social Security, Medicare, and Medicaid is expected to increase substantially as a share of the economy. CBO's December 2005 analysis of the long-term budget outlook projected several different scenarios for growth of the three programs. Under its "intermediate" projection, CBO estimates that spending on the programs will grow the current level of 8.2% of GDP in FY2005 to 15.2% in FY2030 and 19.0% by FY2050.⁷ According to CBO, either increases in taxes or cuts in spending will be necessary in the future if fiscal stability is to be maintained.⁸

For additional information, see CRS Report RL33282, *The Budget for Fiscal Year 2007*, by Philip D. Winters and CRS Report RS22045, *Baseline Budget Projections Under Alternative Assumptions*, by Gregg Esenwein and Marc Labonte.

⁶ Ibid., p. 19.

⁷ U.S. Congressional Budget Office, *The Long-Term Budget Outlook* (Washington: GPO, 2005), p. 10.

⁸ Ibid., p. ix.

The Federal Tax Burden

The broadest gauge of the federal tax burden is the level of federal receipts as a percentage of output (gross domestic product, or GDP). By this measure the federal tax burden has fluctuated considerably over the past five years. In FY2000, federal receipts reached a post-World War II peak as a percentage of output, at 20.9%. By FY2004, however, receipts had fallen to 16.3% of GDP — their lowest level since 1959 — before rising again to 18.3% in FY2005. In part, the fluctuations were a result of the business cycle; the long economic boom of the 1990s helped push receipts to their record level in FY2000, while the ensuing recession and sluggish recovery helped reduce the level of revenues in subsequent years. However, policy changes, too, were responsible: significant tax cuts in 2001, 2002, and 2003 each contributed to the decline in taxes.

Another way to look at the tax burden is to compare it across income classes. In combination, the various components of the federal tax system have a progressive impact on income distribution — that is, upper-income individuals tend to pay a higher portion of their income in tax than do lower-income persons. In isolation, however, the different components of the system have different effects: the individual income tax is progressive, while payroll taxes are progressive in the lower and middle parts of the income spectrum but become regressive as incomes increase. The corporate income tax and estate tax are both progressive, although they impose only a small burden; excise taxes are regressive.

CBO has published distributional analyses for all federal taxes for each year since 1979; the studies use a consistent methodology, so the results can be compared to get an idea of the direction of federal tax policy's distributional impact over the period. According to the studies, the overall effective federal tax rate declined from 22.2% of income in 1979 to 19.8% in 2003, but is estimated to have risen to 21.4% in 2005. Without more detailed analysis, it is not clear whether the system has become more or less progressive over the entire period; while rates in all quintiles have fallen the pattern is mixed.⁹ Since 2000, the system has apparently become slightly less progressive. While the effective tax rate for each quintile of households in the income scale has declined, the decline has tended to be larger for successively higher quintiles.¹⁰

For further information, see CRS Report RS20087, *The Level of Taxes in the United States, 1940-2005*, by David L. Brumbaugh and CRS Report RL32693, *Distribution of the Tax Burden Across Individuals: An Overview*, by Jane G. Gravelle and Maxim Shvedov.

⁹ U.S. Congressional Budget Office, *Effective Federal Tax Rates Under Current Law, 2001 to 2014* (Washington: GPO, 2004), p. 10; and *Historical Effective Federal Tax Rates, 1979 to 2003* (Washington: GPO, 2005). Both reports are available on the CBO website, at [http://www.cbo.gov/], visited Feb. 10, 2006. The percentage-point declines across quintiles, from lowest to highest, are 2.5, 2.3, 3.0, 1.6, and 1.2.

¹⁰ For the lowest to highest quintiles, respectively, the percentage-point declines in effective tax rates between 2000 and 2005 were: 0.9, 1.0, 1.1, 0.9, and 1.7.

Possible Tax Issues in 2007

Following the November 2006 elections, Democratic leaders in the tax-writing committees — Representative Charles Rangel in the House Ways and Means Committee and Senator Max Baucus in the Senate Finance Committee — and other congressional leaders have provided some indications of possible tax issues that may be on the congressional agenda in 2007. Initially, one possible issue was the extenders that were considered by Congress, first as part of reconciliation legislation, and later as part of H.R. 5970, but not approved. However, as noted previously, the extenders were approved as part of H.R. 6111 in a post-election session of the 109th Congress.

Another issue that has received considerable coverage in early post-election reports is the alternative minimum tax (AMT). As described in more detail later in this report (see page 13), an increasing number of taxpayers are subject to the AMT each year, and Democratic leaders have indicated interest in legislation providing AMT relief. However, reducing or repealing the AMT could result in substantial revenue losses, and some Democrats have expressed interest in restoring budget rules that would require revenue-raising measures to offset revenue losses. One possible source of additional revenue that has received interest is the “tax gap” — the difference between the taxes U.S. individuals and firms owe and those they actually pay. Recent IRS estimates place the size of the gap at \$300 billion annually. Other possible revenue-raising areas that have been mentioned include tax shelters, restricting tax benefits for U.S. firms that operate abroad, and restricting tax benefits of oil companies.

Although the 2001 and 2003 tax cuts have been criticized by some for their impact on the budget deficit as well as their distribution across income classes, early indications are that there will not be an effort in early 2007 to repeal the tax cuts enacted in 2001 and 2003.¹¹

Tax Issues in 2006

The “Extenders” (Expiring Tax Provisions)

Separately from the broad tax cuts enacted under EGTRRA and JGTRRA, the tax code contains numerous other tax provisions — almost exclusively tax benefits — that were initially enacted on a temporary basis, with specific expiration dates. The provisions, sometimes termed “extenders,” tend to be relatively narrow in scope, and are generally designed to promote specific types of activity or investment. They have tended to be grouped and considered separately from the more generally applicable tax cuts enacted under EGTRRA and JGTRRA.

¹¹ Ritterspusch, et al., “Rangel Will Not Undo Tax Cuts for AMT.” See also David Wessel, “What Democrats May Do with Their Hard-Won Prize,” *The Wall Street Journal*, Nov. 9, 2006, p. A2.

The specific areas of economic activity covered by the extenders vary widely, and each presents its own unique policy issues. At the same time, however, the basic economic issues presented by almost all the extenders are similar. Economic theory holds that the economy functions most efficiently when taxes or other factors do not distort the allocation of resources by favoring one activity over another. Only in unusual cases, where there is a failure of the market to function properly, is economic efficiency improved by introducing tax distortions. The extenders each present the question of whether the particular benefit they provide corrects a market failure. (Absent such a failure, however, the particular benefit may be supported by a belief in the social benefit of the activity that is promoted.)

In 2006, Congress considered the extenders as part of reconciliation legislation, but did not include them in the reconciliation bill that was enacted (The Tax Increase Prevention and Reconciliation Bill of 2005; see the discussion in the next session). On July 29, however, the House passed H.R. 5970 (the “trifecta” bill), containing extension of 23 provisions that expired at the end of 2005, reduction of the estate tax, and an increase in the minimum wage.¹² The Senate did not take up the bill before the mid-term elections.

Tax policymakers, however, regarded the extenders as an issue with some urgency. Business planners and individuals faced uncertainty regarding their 2006 taxes. Uncertainty about the extenders also presented administrative difficulties for the Internal Revenue Service. Congress thus resumed consideration of the extenders in its post-election session in early December. On December 9, the Senate approved an extenders bill (H.R. 6111) that had been approved by the House on December 8. In general, the bill extends the temporary provisions for an additional two years (through 2007). The revenue cost of the extenders is estimated at \$38.1 billion over five years and \$45.1 over 10 years. The measure also contains non-tax items related to Medicare and trade.

The following is a list of the temporary provisions extended by H.R. 6111. The extensions are retroactive, and are for two years (through 2007).

- Research and experimentation tax credit
- Deduction of state and local sales taxes
- Deduction for qualified tuition and related expenses
- Welfare-to-work and work opportunity credits
- Depreciation rules for leasehold and restaurant improvements and new restaurant property
- New markets tax credit
- Accelerated depreciation for business property on Indian reservations
- Expensing of brownfields environmental remediation costs

¹² Both the Senate and House passed similar extender legislation with TIPRA. However, the extenders were not included in the final act. Two exceptions — that is, two provisions that were included in TIPRA — were the increased expensing allowance for small business and the removal of international active financing income from coverage under Subpart F.

- Election to include combat pay in earned income tax credit calculation
- Qualified zone academy bonds
- Teachers' classroom expense deduction
- Tax Incentives for investment in District of Columbia
- Indian employment tax credit
- Increased cover-over of rum tax revenues to Puerto Rico and Virgin Islands
- Application of limits to mental health benefits
- Disclosure of tax return information
- Enhanced deductions for charitable contributions of computer property
- Medical savings accounts
- Suspended limit on percentage depletion for oil and gas wells
- Economic development credit for American Samoa
- Bonus depreciation for Gulf Opportunity Zone
- Authority for IRS undercover operations

For further information, see CRS Report RS22117, *List of Temporary Tax Provisions: 'Extenders' Expiring in 2005*, by Pamela J. Jackson.

Taxes and Budget Reconciliation

On April 28, 2005, Congress approved an FY2006 budget resolution (H.Con.Res. 95) with reconciliation instructions calling for three bills: a bill containing spending cuts (\$1.5 billion in FY2006 and \$34.7 billion over five years); a bill increasing the public debt limit by \$781 billion (to \$8,965 billion); and a bill containing tax cuts. The reconciliation instructions for taxes called for tax cuts of \$11 billion in FY2006 and \$70 billion over five years.

As 2005 entered its closing months, Congress began consideration of the tax-reduction reconciliation legislation. On November 8, Chairman Grassley of the Senate Finance Committee released the details of a "chairman's mark," containing the proposed contents of a tax reconciliation bill. On November 10, Chairman Thomas of the House Ways and Means Committee introduced his own chairman's mark. On November 15, both committees approved modified versions of the respective chairman's marks (S. 2020 in the Finance Committee and H.R. 4297 in the Ways and Means Committee). On November 18, the full Senate approved S. 2020, with slight modifications, and the House approved H.R. 4297 on December 8. On February 2, 2006, the Senate approved H.R. 4297 after amending it by replacing the contents of the House-passed bill with those of S. 2020.

The figures in the budget resolution did not place an absolute limit on the tax cuts Congress could pass for FY2006 or subsequent years — for example, the budget resolution itself called for a total of \$106 billion in tax cuts over five years, with only \$70 billion contained in budget reconciliation instructions. However, tax cuts specified in the reconciliation instructions are protected from certain points of order under Senate budget consideration rules; if a point of order is raised, a supermajority is required for passage. Thus, as a practical matter, the \$70 billion five-year and \$11 billion FY2006 reconciliation figures posed a constraint on the amount of tax cuts

that were likely to be considered, and led to trade-offs between specific tax cuts and the adoption of revenue-raising offsets.

An important element of both the House and Senate bills was the extension of a number of previously enacted temporary tax cuts that are scheduled to expire at various times over the next several years. (Note that these measures are generally distinct from the relatively broad cuts in tax rates and other areas that were enacted in 2001 with the Economic Growth Tax Relief and Reconciliation Act, but that are scheduled to expire at the end of 2010.) According to estimates by the Joint Committee on Taxation (JCT), the Senate bill would have reduced revenue by \$69.4 billion over five years, by \$49.5 billion over 10 years, and by \$983 million in FY2006.¹³ The House bill was estimated to reduce revenue by \$55.6 billion over five years, \$80.1 billion over 10 years, and by \$4.9 billion in FY2006.¹⁴

A large number of extended provisions were common to both bills; in most (but not all) cases, the extensions carried through the end of 2006. Some of the more prominent extensions in both bills were the alternative deduction for state and local sales taxes, the research and experimentation tax credit, the deduction for higher-education expenses, the 15-year depreciation recovery period for leasehold improvements and restaurants, and the work opportunity and welfare-to-work tax credits. Both bills also extended the increased “expensing” tax benefit for small business investment through 2009.

Two prominent extensions that differed between the two proposals were the increased alternative minimum tax (AMT) exclusion for individuals and reduced rates for capital gains and dividends. The Senate plan extended the AMT exclusion for one year, but did not extend the capital gains and dividend rate-reductions; the House bill extended the dividend and capital gains reductions for two years (through 2010), but did not extend the AMT exclusion. The House bill did, however, extend the applicability of nonrefundable personal tax credits against the AMT for one year, as did the Senate bill (albeit for two years). In addition, on December 7, 2005, the House passed a one-year extension of the increased AMT exemption as a “stand alone” bill (H.R. 4096).

Due to the prominence of the AMT and dividend/capital gains issues, some background information is useful. The temporary tax cut for capital gains and dividends was enacted by the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27). JGTRRA reduced the tax rate on both capital gains and dividends to 15% (5% for income in the 15% and 10% regular-income brackets, with complete elimination in 2008). However, the reductions are temporary and are scheduled to expire on January 1, 2009. Absent congressional action, the capital gains rate will revert to prior law’s 20% rate (10% for income in the lowest brackets).

¹³ U.S. Congress, Joint Committee on Taxation, *Comparison of the Estimated Revenue Effects of the Tax Provisions Contained in H.R. 4297, the “Tax Relief Extension Reconciliation Act of 2005,” As Passed by the House, and H.R. 4297, the “Tax Relief Act of 2005,” As Amended by the Senate*, JCX-10-06, Feb. 9, 2006, 7 pp. Available on the Joint Committee’s website at [<http://www.house.gov/jct/x-10-06.pdf>].

¹⁴ *Ibid.*, p. 7.

Dividends will be taxed under the tax rates applicable to regular income, which range from 10% to 35%, but which are also scheduled to revert to a 15% to 39.6% range in 2011. According to JCT estimates, a two-year extension of the reduced rates for capital gains and dividends would reduce revenue by an estimated \$20.6 billion over five years and \$50.8 billion over 10 years.¹⁵

The context of the AMT exemption's extension is this: individuals generally pay either their AMT or regular tax, whichever is higher; a taxpayer's tentative AMT is partly dependent on a flat exemption amount specified by law. The value of the exemption is subject to erosion due to inflation and the growth of real income. Partly for this reason, an increasing number of taxpayers are faced with the possibility of paying the AMT rather than the regular tax. Beginning in 2001, Congress enacted a series of temporary increases in the exemption. The most recent increase was provided by the Working Families Tax Relief Act of 2004 (P.L. 108-121). Under its terms the exemption is \$58,000 for couples and \$40,250 for individuals. However, the increase expires at the end of 2005, and — absent congressional action — in 2006 the exemption will revert to prior law's level of \$45,000 and \$33,750 for couples and individuals respectively. According to estimates by the Joint Committee on Taxation (JCT), a one-year extension of both the increased exemption and the AMT-applicability of personal tax credits would result in a revenue loss of \$33.9 billion over five years.¹⁶

In addition to the differences between the “extenders,” the Senate proposal contained several sets of items not contained in the House bill. These included a number of tax cuts for areas affected by the recent hurricanes and a set of provisions applying to charitable contributions. The disaster-related provisions were generally more in the nature of development incentives for stricken areas than were the provisions of the Katrina Emergency Tax Relief Act (P.L. 109-73) that was enacted in September. The early measure generally focused more on providing direct tax relief to individuals affected by the hurricanes. While disaster-related provisions were not contained in the House reconciliation bill (H.R. 4297), on December 7, the House passed H.R. 4440, containing disaster-related tax benefits. The Senate passed the bill on December 16, and the President signed the measure (P.L. 109-135).

The Senate bill included several incentives to encourage charitable giving: a non-itemizer deduction; an allowance for tax-free distributions from IRAs for charitable purposes; an enhanced deduction for charitable contributions of food and book inventory; a basis adjustment to the stock of S corporations¹⁷ that contribute

¹⁵ U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of the Conference Agreement for the “Tax Increase Prevention and Reconciliation Act of 2005,”* JCX-18 — 06, May 9, 2006, p. 2. Available on the committee's website, at [<http://www.house.gov/jct/x-18-06.pdf>].

¹⁶ *Ibid.*, p. 2.

¹⁷ “S corporations” are corporations that are relatively closely held and, having met requirements set forth in the tax code, are not subject to the corporate income tax. S corporation shareholders are taxed on their share of S-corporation income, however, whether it is paid as dividends or not.

property for charitable purposes; and a change in the tax treatment of certain payments to controlling exempt organizations.

Although these proposals would reduce revenue, the Senate bill also included charity-related reforms that would raise revenue. These include provisions intended to limit the involvement by exempt organizations in tax-shelter transactions; doubling certain fines and penalties applicable to charitable organizations; and implementation of certain other changes.¹⁸

The Senate proposal contained a number of additional revenue-raising measures, which are also not present in the House bill. The largest of these is codification of the “economic substance” doctrine that is aimed at suppressing corporate tax shelters. Another prominent revenue-raiser was a proposal to require large integrated oil companies who use the Last In First Out (LIFO) method of inventory accounting to revalue their inventories.

The Conference Agreement. On May 9, a conference committee approved a budget reconciliation tax bill (H.R. 4297, the Tax Increase Prevention and Reconciliation Act of 2005. The President signed the measure on May 17; it became P.L. 109-222.) The bill extends both the dividend and capital gains reduction (for two years) and AMT relief (for one year), and extends the increased business expensing allowance. The conference agreement, however, did not include most other extensions contained in the House and Senate bills. (According to press reports, the extensions not contained in H.R. 4297 may be addressed by subsequent legislation not included in the budget reconciliation process.¹⁹) In addition, the conference agreement did not contain the bulk of the revenue-raising items contained in the Senate bill. It did not include, for example, either modifications to the economic substance doctrine or accounting changes for oil companies. Joint Committee on Taxation estimates indicate the conference agreement will reduce revenue by a net amount of \$70 billion over five years and by \$10.8 billion in FY2006.²⁰

The conference agreement’s one-year extension of AMT provisions applies to 2006, and includes both the applicability of personal tax credits against the AMT that was contained in both the House and Senate bills (though for different periods) and the increased exemption amount. The increased exemptions will be higher than those applicable to 2005, reflecting indexation for inflation. The exemption amount will be \$62,550 for joint returns and \$42,500 for single returns.

The extended dividend/capital gains tax cut will apply to 2008 and 2009. The increased expensing provision was extended for two years, for 2008 and 2009.

¹⁸ Pamela J. Jackson contributed the sections on charitable giving.

¹⁹ Kurt Ritterpusch, “Conferees Reach Reconciliation Accord, Strip Some FSC Benefits to Offset Cost,” *BNA Daily Tax Report*, May 10, 2006, p. GG-1.

²⁰ U.S. Congress, Joint Committee on Taxation, *Estimated Revenue Effects of the Conference Agreement for the “Tax Increase Prevention and Reconciliation Act of 2005,”* JCX-18 — 06, May 9, 2006, p. 3. Available on the committee’s website, at [http://www.house.gov/jct/x-18-06.pdf].

For additional information on the budget, see CRS Report RL32812, *The Budget for Fiscal Year 2006*, by Philip Winters. For more information on expiring tax provisions, see the section below.

Scheduled Expiration of the 2001 Tax Cuts

The Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16) provided a substantial tax cut that it scheduled to be phased in over the 10 years following its enactment. However, to comply with a Senate procedural rule for legislation affecting the budget (the “Byrd rule”), the act contained language “sunsetting” its provisions after calendar year 2010. Thus, all of EGTRRA’s tax cuts expire at the end of 2010.

The most prominent provisions EGTRRA scheduled for phase-in were:

- reduction in statutory individual income tax rates;
- creation of a new 10% tax bracket;
- an increase in the per-child tax credit;
- tax cuts for married couples designed to alleviate the “marriage tax penalty”; and
- repeal of the estate tax.

In addition, EGTRRA provided for a temporary reduction in the individual alternative minimum tax (AMT) by increasing the AMT’s exemption amount, but scheduled the AMT relief to expire at the end of 2004.

The Jobs and Growth Tax Relief and Reconciliation Act of 2003 (JGTRRA; P.L. 108-27) provided for the “acceleration” of most of EGTRRA’s scheduled tax cuts — that is, it moved up the effective dates of most the tax cuts EGTRRA had scheduled to phase-in gradually, generally making them effective in 2003. (The phased-in repeal of the estate tax was not accelerated by JGTRRA.) Many of JGTRRA’s accelerations, however, were themselves temporary and were scheduled to expire at the end of 2004. Also, JGTRRA temporarily implemented a reduction in the maximum tax rate on dividends and capital gains, reducing the rates to 15% (5% for individuals in the 10% and 15% marginal income tax brackets). The reduction was initially scheduled to expire at the end of 2008.

In 2004, Congress thus faced two “expiration” issues related to EGTRRA and JGTRRA. One was a question for the longer term: the scheduled expiration of EGTRRA’s tax cuts at the end of 2010. The second was the expiration of JGTRRA’s accelerations at the end of 2004. In September, Congress addressed the second of these with enactment of the Working Families Tax Relief Act (WFTRA; P.L. 108-311). WFTRA generally extended JGTRRA’s accelerations of EGTRRA’s tax cuts through 2010 — that is, up to the point at which EGTRRA’s cuts are scheduled to expire. WFTRA also extended EGTRRA’s increased AMT exemption for one year.

In 2005, the Tax Increase Prevention and Reconciliation Act (TIPRA; P.L. 109-222) extended JGTRRA’s dividend and capitals gains rate cuts along with its AMT reduction. The dividend and capital gains cuts were extended through 2010 and the increased AMT exemption through 2006.

The issue of EGTRRA's scheduled expiration at the end of 2010 thus remains, and was debated in Congress throughout 2006. The debate over extension of the tax cuts has centered on three broad issues: its likely impact on the federal budget deficit; its possible effect on long-term economic growth; and its results for the fairness of the tax system. In general, opponents of an extension have argued that it would exacerbate a budget situation already made difficult by the looming retirement of the baby-boom generation and resulting stresses on the social security system. Those supporting extension maintain that the tax cuts — through their positive effects on work effort and saving — will stimulate long-term growth, a development that will ease the adverse effects of the tax cuts on the budget. (Opponents question whether these effects will be large enough to offset the extensions' budget effects.) With respect to fairness, opponents of extending the measures argue that the tax cuts reduce the progressivity of the tax system by providing larger effective tax-rate reductions for upper-income individuals than for persons in lower income brackets. Proponents of the tax-cut extensions emphasize that they would provide tax cuts across all income classes.

For additional information, see CRS Report RS21992, *Extending the 2001, 2003, and 2004 Tax Cuts*, by Gregg Esenwein.

The Alternative Minimum Tax for Individuals

While EGTRRA's expiration presents a timing issue focused on a specific date, the individual AMT is an issue for which time is a critical element but in a less specific way: absent legislative action, as each year passes more and more individuals will be subject to the AMT rather than the regular tax. According to one recent study, in 2001 2.4 million individual income tax returns (1.8% of the total) contained an AMT liability; in 2004 an estimated 3.5 million returns (2.6%) had an AMT liability. In 2010, an estimated 37.1 million returns (25.6%) will owe the AMT.²¹ The portion will decline for a number of years thereafter if EGTRRA's expiration occurs as scheduled, but then will resume growth.

The reason for the increase in the applicability of the AMT is its basic mechanics. The AMT functions like a parallel income tax, with lower rates than the regular tax but with a broader base — that is, with fewer deductions, exemptions, credits, and special tax preferences than are allowable under the regular tax. Each year, a taxpayer pays either his or her regular tax or the tentative AMT, whichever is higher. Taxpayers are permitted a flat exemption amount in calculating their AMT. However, the exemption is fixed at a flat dollar amount that is not indexed for inflation. And while the AMT only has two rate brackets (26% and 28%), the bracket dividing point is likewise not indexed. In contrast, the structural features of the regular income tax — personal exemptions, the standard deduction, and rate-bracket thresholds — are indexed. Thus, as time passes and incomes grow in both real and nominal terms, the AMT exceeds the regular tax for more taxpayers. The phenomenon was magnified by the rate reductions and tax cuts for married couples provided by EGTRRA and JGTRRA as well as other tax cuts enacted in the past. As

²¹ Daniel Feenberg and James M. Poterba, "The Alternative Minimum Tax and Effective Marginal Tax Rates," *National Tax Journal*, vol. 57 part II, June 2004, p. 412.

described above, Congress addressed the AMT on a temporary basis in 2001 and 2003 under EGTRRA and JGTRRA by increasing the exemption amount, thus reducing the number of taxpayers who would otherwise pay the AMT. In 2004, WFTRA extended through 2005 an exemption amount of \$58,000 for married couples and \$40,250 for single filers. In 2006, TIPRA extended the increased exemption for one year. Under TIPRA, the exemption amount is \$42,500 (singles) and \$62,550 (couples) for 2006. Absent further action, the exemption amounts will revert in 2007 to the pre-EGTRRA amounts of \$45,000 and \$33,750 for couples and singles, respectively.

The original purpose of the AMT was to ensure that no individual with substantial income measured in economic terms could use tax benefits and omissions from the tax base to reduce his or her tax liability below a certain point. There are a number of reasons why policymakers may be concerned with the prospect of its increased applicability. First, taxpayers who become subject to the AMT face a higher tax liability than they otherwise would; some taxpayers moving into AMT status may thus view the applicability of the AMT as a tax increase. Second, taxpayers in AMT status are not able to fully participate in tax cuts enacted under the regular tax. For example, application of the AMT prevented those taxpayers subject to the AMT from fully realizing the tax cuts enacted under EGTRRA and JGTRRA. Third, the AMT introduces complexity to the tax system, and the amount of time spent in tax preparation increases for taxpayers in or near AMT status.

On a more conceptual level, the AMT can be viewed as balancing conflicting goals of the income tax. On the one hand, various deductions, exemptions, credits, and other benefits under the regular income tax are thought to be useful in promoting various activities thought to be socially desirable or conducive to economic growth. On the other hand, it is often thought desirable for a tax system to achieve a certain level of fairness, both in horizontal terms (the equal treatment of individuals in different circumstances) and vertical terms (the relative treatment of individuals at different income levels). Further, economists argue that broad-based tax systems with low rates — a characteristic of the AMT — are less damaging to economic efficiency than higher-rate systems that apply to bases laden with special benefits. With the AMT, taxpayers can use the tax benefits available under the regular tax only up to a point, where considerations of equity and efficiency trigger applicability of the AMT: the benefits' economic growth and social goals are balanced with fairness and efficiency concerns. To the extent the AMT's growth has resulted from inflation and lack of indexation, it might be argued that the AMT's advance is unintended, and the balance between equity and social and economic goals intended for the AMT has been upset.²²

A factor that substantially complicates the AMT issue is its revenue effect, which assumes increased prominence given current federal budget deficits. For example, indexing the AMT for inflation would eliminate much of the impetus of the tax's increasing applicability. According to Congressional Budget Office (CBO)

²² It might be argued that the level intended by Congress is that established under the Omnibus Budget Reconciliation Act of 1993 (P.L. 103-66), where the permanent exemption levels and bracket amounts and rates were established.

indexing the AMT would reduce federal revenues by \$385 billion over ten years, an amount equal to 1.3% of federal revenues expected over the period. If EGTRRA's tax cuts are extended or made permanent, the cost of restraining the AMT would be considerably larger, reducing revenue by \$642 billion, or 2.1% of revenue.

For further information, see CRS Report RL30149, *The Alternative Minimum Tax for Individuals*, by Gregg A. Esenwein and CRS Report RS22100, *The Alternative Minimum Tax for Individuals: Legislative Initiatives and Their Revenue Effect*, by Gregg A. Esenwein.

Tax Reform

There are indications that tax reform — either incremental changes to the current system or a more fundamental reform — may begin to be actively considered by Congress in 2006. President Bush, in his September, 2004, speech accepting the Republican nomination for President, called for reform whose goals would be simplification, fairness, and economic growth. In January, 2005, the President appointed an advisory panel to study the topic and report to the Secretary of the Treasury. The panel issued its report on November 1, 2005 (see below).

Numerous tax reform bills were introduced in the 108th Congress and a number of measures have been proposed thus far in the 109th Congress. In the 109th Congress, the content of the proposals ranges from plans for a flat-rate consumption tax (S. 1099) to a proposed national retail sales tax (H.R. 25/S. 25), to a bill that requires the Secretary of the Treasury to conduct an analysis of a transactions tax.

More generally, proposals for the general reform of the tax system have taken one of two conceptual forms: a tax on a comprehensive measure of income; or a tax on consumption. Both types of reform proposals typically involve broadening the tax base while reducing the tax rates that apply to the base. A comprehensive income tax would apply at the same rate to all income, regardless of its use or its source, thus eliminating many of the special deductions and credits contained in the current system. A consumption tax would only apply to that portion of income that is spent on consumption and would not apply to saving. Both types of reform are generally championed on grounds of economic efficiency — because they apply more evenly across different types of income, broad-based taxes are less distorting of economic decisions and thus permit a more smoothly working economy. Because consumption taxes do not apply to saving, their adherents argue that they better promote saving and investment and thus economic growth. Critics, however, are skeptical of how responsive savers actually are to the presence or absence of taxes and point to the greater difficulty in establishing progressivity under a consumption tax. Each type of tax reform is also frequently supported on grounds of simplicity; the substantial (and apparently growing) complexity of the current tax system is often cited as a primary reason for tax reform. Skeptics, however, point out that the three goals of most tax reform plans — economic performance, equity, and efficiency — are frequently at odds, so that even the most carefully-designed reform plan cannot achieve perfection in all three areas.

Like any thorough rearrangement of economic relationships, fundamental tax reform would produce complex transition effects and there would be both winners

and losers across economic actors and taxpayers. For example, broadening of the base would necessarily entail elimination of a variety of deductions and credits favoring particular activities, investments, or types of income, and there are doubtless some who would lose more from the elimination of such preferences than they would gain from a reduction in statutory tax rates. And, in the case of a switch to a consumption tax, owners of existing capital — for example, owners of corporate stock — would register a windfall loss as a transition effect. These changes could also lead to inflation and recession, which could be serious for certain types of consumption taxes.

The complexity and magnitude of the transition effects suggest that if Congress does adopt fundamental tax reform, the path would be arduous and debate would be heated. To illustrate, Congress in the mid-1990s actively considered fundamental tax reform without adopting it: numerous reform bills were introduced and hearings were held by the tax-writing committees.²³ And even when tax reform has been achieved, it has eroded over time: the Tax Reform Act of 1986 (P.L. 99-514) was a substantial movement toward a reformed tax on comprehensive income. Over the past two decades, however, the grand compromise the act embodied — lower rates exchanged for fewer special tax benefits — has come unwound, suggesting the difficulty of crafting an enduring version of tax reform.

The President’s Advisory Panel on Tax Reform. The advisory panel formed by President Bush in January 2005 conducted public hearings as well as closed meetings over the spring, summer, and fall of 2005. After several delays, the panel submitted its recommendations to the Secretary of the Treasury in November, 2005.

The panel proposed two alternative tax systems — what it termed the Simplified Income Tax Plan (SITP) and the Growth and Investment Tax Plan (GITP). Both systems, the panel stated, were designed to be roughly “revenue neutral” — raising as much added tax revenue as they would lose. Both systems would broaden the tax base by ending some individual income tax deductions — for example, the deduction for state and local income taxes — but would also retain revamped tax benefits in other areas — for example, for home ownership. Under both plans, personal exemptions, the standard deduction, and the child tax credit would be replaced with a new Family Credit that would vary in size, depending on filing status. Both systems would repeal the alternative minimum tax and would reduce statutory tax rates. In broad terms, the SITP would be a revised income tax with a broadened base and lowered rates. The GITP would be similar to a consumption tax, but with some exceptions (for example, it would tax income from financial investment, such as interest, dividends, and capital gains).

The two plans differ primarily in their treatment of business income and income from capital investment and saving. The SITP would retain the corporate income tax rate, but at a reduced rate and with a simplified method of accelerated depreciation.

²³ See, for example, U.S. Congress, House Committee on Ways and Means, *Replacing the Federal Income Tax*, 104th Cong., 1st sess., June 6, 7, and 8, 1995 (Washington: GPO, 1995), 1,055 pp.

Also, income from U.S. firms' overseas operations would not be taxed, thus implementing a "territorial" tax system. Corporations would still be able to deduct interest. While the corporate-level tax would be retained, shareholders would not be taxed on dividends and would exclude 75% of capital gains from tax, while interest would still be taxed to individuals at regular tax rates. The system would thus move towards eliminating double-taxation of corporate-source income, moving towards a "full integration" system.

The GITP would retain the corporate income tax, but in altered form: it would permit firms to fully deduct ("expense") capital investment in the year of acquisition. Expensing is the mathematical equivalent of an exemption for income from new investment. Thus, the GITP would effectively do away with business tax on new investment; income from existing investment, however, would continue to be taxed. Interest would no longer be deductible at the corporate level. A destination-based "border tax adjustment" would be implemented similar to those used with value-added taxes: the tax on exports would be rebated but tax would be imposed on imports. Shareholders and corporate creditors would continue to be taxed on dividends and interest, albeit at a reduced (15%) rate. GITP thus partly removes current law's double-taxation of corporate-source income.

For additional information on tax reform in general, see CRS Report RL33443, *Flat Tax Proposals and Fundamental Tax Reform: An Overview*, by James M. Bickley; CRS Report RL32603, *The Flat Tax, Value-Added Tax, and National Retail Sales Tax: Overview of the Issues*, by Gregg Esenwein and Jane G. Gravelle; and CRS Report RL33545, *The Advisory Panel's Tax Reform Proposals*, by Jane G. Gravelle. The details of the Tax Reform Advisory Panel's proposals are online at the panel's website, at [<http://www.taxreformpanel.gov/final-report/>].

The Estate Tax

Under provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA, P.L. 107-16), the estate tax and generation-skipping transfer tax are scheduled to be repealed effective January 1, 2010. But the estate tax repeal, and all other provisions of EGTRRA, are scheduled to sunset December 31, 2010. If the sunset provision is not repealed, or the law is not otherwise changed beforehand, in 2011 estate and gift tax law will return to what it would have been had EGTRRA never been enacted. The unified estate and gift taxes will be reinstated with an exemption of \$1 million. The maximum tax rate will revert to 55%.

Both before and after the enactment of EGTRRA, there have been efforts in Congress, primarily by Republicans, to make estate tax repeal permanent. The 106th Congress passed legislation that was vetoed by President Clinton in August 2000. In both the 107th and 108th Congresses, the House passed legislation making the repeal permanent, but the Senate did not. Democrats introduced bills, not enacted, that would have retained the estate tax but raised the applicable exclusion amount.

The Bush Administration's budget for FY2007 once again endorsed permanent repeal of the estate tax. On April 13, 2005, the House passed H.R. 8, a bill that would permanently repeal the estate tax starting in 2010. The House defeated the Pomeroy substitute amendment, which would have retained the estate tax with higher

applicable exclusion amounts. Numerous other bills to repeal or alter the estate tax have been introduced in the 109th Congress. In June 2006, the Joint Committee on Taxation (JCT) estimated that enacting legislation in 2006 to make estate tax repeal permanent effective in 2010 would cost \$387 billion in lost revenues over the 10-year forecast period FY2007-FY2016 (which includes five years of full repeal).

On June 8, 2006, the Senate voted on cloture on a motion to consider H.R. 8, but the motion fell three votes short of the 60 votes needed. Efforts continued on developing a compromise proposal. On June 19 House Ways and Means Committee Chairman William Thomas introduced H.R. 5638, intended as a compromise measure. The bill proposed to restore the unified estate and gift tax exclusion and raise the exclusion amount to \$5 million per decedent (indexed for inflation), beginning in 2010. Any unused exclusion could be carried over to the estate of the surviving spouse. The tax rate on taxable assets up to \$25 million would be equal to the tax rate on capital gains (currently 15% but scheduled to revert to 20% in 2011). The tax rate on assets over \$25 million would be twice the capital gains rate. The deduction for state death taxes would be repealed. The JCT estimated that the estate tax provisions of H.R. 5638 would cost \$279 billion over FYs 2006-2016, or 72% as much as total repeal. On June 22 the House approved H.R. 5638 by a vote of 269-156.

The Senate did not vote on H.R. 8 during the first weeks of July. On July 29, the House approved H.R. 5970, a bill containing a modified version of H.R. 5638's estate tax provisions, along with extension of a set of expiring tax provisions (the "extenders," including measures such as the research and experimentation tax credit and work opportunity and welfare-to-work tax credits) and an increase in the minimum wage. On August 3, the Senate failed to approve a cloture motion that would have led to consideration of the bill in the Senate.

This section was written by Nonna A. Noto. For more information, see CRS Report RL32818, *Estate Tax Legislation in the 109th Congress*, by Nonna A. Noto.