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Major Tax Issues in the 110th Congress

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Summary

As 2006 came to a close, congressional leaders in the tax-writing committees and elsewhere have provided some indications of tax issues that may be on the congressional agenda in 2007. One issue whose urgency was reduced, however, was the fate of a set of temporary tax benefits (the "extenders") that generally expired at the end of 2005: Congress approved a bill extending the provisions (the Tax Relief and Health Care Act of 2006; P.L. 109-432) during the first week of December in its post-election session. Nevertheless, a number of significant tax issues remain that Congress may address in 2007.

Prominent among upcoming issues is the alternative minimum tax (AMT) for individuals. Under current law, individuals are generally required to pay either the AMT or the regular tax, whichever is greater. Unlike the regular tax, however, structural components of the AMT are not indexed for inflation. Thus, given rising prices, the growth of incomes, and enactment of tax cuts under the regular tax, a growing portion of taxpayers are subject to the AMT each year; and its coverage has begun to affect middle-class taxpayers (along with the upper-income individuals who were those principally subject to the tax in prior years). In past years, Congress has addressed the growth of the AMT by enacting temporary measures ("patches") that restrict its scope. Recently, however, Congressional leaders have expressed an interest in seeking a more long-term solution to the AMT's increased scope.

Other tax issues that Congress may address include the question of whether to extend the broad tax cuts first enacted in 2001 — for example, the expanded child credit, reduced individual tax rates, tax cuts for married couples, and repeal of the estate tax. The cuts are scheduled to expire at the end of 2010, and during 2006, Congress evinced considerable interest in making the tax cuts permanent. Notwithstanding the results of the mid-term elections, the 110th Congress may return to the question of extending the tax cuts in either their initial or altered form.

In the current era of federal budget deficits, a dilemma with tax-cutting measures is their likely cost in terms of foregone tax revenue. Extending the 2001 tax cuts or repealing the AMT, for example, would reduce tax revenue by substantial amounts. Accordingly, there has been some discussion of a number of revenue-raising measures that would offset some or all of the cost of revenue-losing tax cuts. Items that have been mentioned prominently include increased attention to the "tax gap" — the difference between the taxes U.S. individuals and firms owe and what they actually pay — as well as tax shelters, restricting tax benefits for U.S. firms that operate abroad, and restricting tax benefits for oil companies. In addition, some in Congress have indicated support for strengthening rules designed to restrict the federal budget deficit.

Congress, of course, does not consider tax policy in an economic or budgetary vacuum. This report thus provides a broad view of tax policy's context before taking a closer look at the particular tax issues that appear likely to arise in 2007. The report will be updated as legislative and economic events occur.

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As 2006 came to a close, congressional leaders in the tax-writing committees and elsewhere provided some indications of possible tax issues that may be on the congressional agenda in 2007. One issue whose urgency was reduced, however, was the fate of a set of temporary tax benefits (the "extenders") that generally expired at the end of 2005: Congress approved a bill extending the provisions (H.R. 6111, the Tax Relief and Health Care Act of 2006) in its post-election session during the first week of December. Other tax issues remain, however, that may be taken up in 2007.

Prominent among upcoming issues is the alternative minimum tax (AMT) for individuals. As described in more detail later in this report, 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.

Another tax question that may arise before the end of the 110th Congress is the fate of the tax cuts first enacted with the Economic Growth Tax Relief and Reconciliation Act of 2001 (EGTRRA; P.L. 107-16). EGTRRA's tax cuts are distinct from the extenders in their scope — the 2001 cuts are generally broader than the more narrowly targeted extenders and include provisions such as individual tax rate reductions, expansion of the child tax credit, tax cuts for married couples, and repeal of the estate tax. Like the extenders, however, EGTRRA's tax cuts are temporary and are scheduled to expire at the end of 2010. An issue that Congress may debate over the course of 2007 and in the lead-up to the 2008 elections is whether to extend or make permanent EGTRRA's cuts, either in their initial or modified form.

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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, taxes can affect the distribution of income across income levels (affecting "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 recent, current, 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]

The outlook for 2007 according to 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

[1] Ben S. Bernanke, testimony before the Committee on Banking, Housing, and Urban 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.

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 stimuli continues to resonate. For example, one subject of debate is the extent to which tax cuts are responsible for the economy's rebound since the last recession and the extent to which factors such as monetary policy are responsible.[3] 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 registered a deficit equal to 1.9% of GDP in FY2006.[4] 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.[5] 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, though not by a wide margin. Revenues are projected to have declined from 20.9%

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[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] U.S. Congressional Budget Office, *Monthly Budget Review*, Nov. 6, 2006, p. 1.

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

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]

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

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[6] Ibid., p. 19.

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

[8] Ibid., p. ix.

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 both 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.

Possible Tax Issues in 2007

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

[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/]. 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.

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.[11] The portion will decline for a number of years thereafter if EGTRRA's expiration occurs as scheduled, but then will resume growth. Following the November 2006 mid-term elections, Democratic leaders of the tax-writing committees indicated that AMT relief is a high priority.[12]

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 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, the Working Families Tax Relief Act (WFTRA; P.L. 108-311) extended through 2005 an exemption amount of $58,000 for married couples and $40,250 for single filers. In 2006 the Tax Increase Prevention and Reconciliation Act (P.L. 109-222) 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 could use tax benefits and omissions from the tax base to reduce his or her tax liability below a certain point. There are several 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

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[11] 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.

[12] Kurt Ritterspusch, et al., "Rangel Will Not Undo Tax Cuts for AMT; Many Optimistic on Passing Extenders Bill," BNA *Daily Tax Report*, Nov. 9, 2006, p. GG.

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 considered to be socially desirable or conducive to economic growth. On the other hand, it is often deemed desirable for a tax system to achieve a certain level of fairness, both in horizontal terms (the equal treatment of individuals with the same income but 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.[13]

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), indexing the AMT would reduce federal revenues by $513 billion over 10 years, an amount equal to 1.6% 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.[14]

Energy Taxation

Democratic leaders have stated that energy taxation is an issue they intend to address early in the new Congress. Their focus appears to be two-fold: a revenue-raising scaling-back of tax cuts for the petroleum firms that were enacted in recent years; and enactment of a new set of incentives aimed at energy conservation and promotion of alternative energy sources.

One of the revenue-raising items that is being considered is denial of the tax code's section 199 domestic production deduction to certain oil and gas related

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[13] 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.

[14] U.S. Congressional Budget Office, *The Budget and Economic Outlook: An Update,* p. 19.

income.[15] The deduction was first enacted with the American Jobs Creation Act of 2004 (P.L. 108-357) and applies to the domestic U.S. manufacturing, extractive, and agriculture industries in general, not just to the petroleum industry. The deduction is phased in, with a rate equal to 6% of domestic production income in 2007-2009, and a permanent rate of 9% in 2010 and thereafter. Indications are that 2007 legislation may be patterned after H.R. 5218 (Representative McDermott) of the 109th Congress, which would have denied the deduction to "the production, refining, processing, transportation, or distribution" of oil or natural gas.

A second revenue-raising provision that is being considered is repeal of the five-year amortization of geological and geophysical (G&G) costs undertaken by major integrated oil companies. The Energy Policy Act of 2005 (EPACT05; P.L. 109-58) initially enacted the provision, which provides a tax benefit for oil and gas exploration and development. Economic theory indicates that, to measure income accurately, outlays that help create oil wells and other assets having value should be deducted only as the assets lose their worth. In the case of profitable wells, two-year amortization therefore likely provides favorable treatment similar to accelerated depreciation. Initially, EPCT05's treatment applied to both integrated producers (i.e., large companies) and independent producers. The Tax Increase Prevention and Reconciliation Act of 2006 (TIPRA; P.L. 109-222) lengthened the amortization period to five years for integrated producers. Democratic proposals would further lengthen the amortization period for integrated producers.

There are indications that at least part of the revenue produced by cutting energy tax benefits may be used to offset the revenue loss from expanded tax incentives to develop renewable and alternative energy sources—for example, hydropower, biofuel and ethanol, nuclear power, geothermal power, and solar energy.[16]

For a more detailed overview of energy tax policy, see CRS Report RL33578, *Energy Tax Policy: History and Current Issues*, by Salvatore Lazzari; and CRS Report RL33763 *Oil and Gas Subsidies: Current Status and Analysis*, by Salvatore Lazzari.

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.

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[15] Wesley Elmore, "Democrats Outline Early Agenda for 110th Congress," *Tax Notes*, Jan. 8, 2007; Kurt Ritterpusch, "Early Components in Democrats' Oil Industry Rollback Plan Firm Up," BNA *Daily Tax Report*, Jan. 5, 2006.

[16] Steven Mufson, "Democrats Hope to Take from Oil, Give to Green Energy, *The Washington Post*, Jan. 4, 2007, p. A01; Kurt Ritterpusch, "Baucus Says Subcommittee on Energy Could be Added to Finance Committee," BNA *Daily Tax Report*, Jan. 8, 2007.

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 of 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, TIPRA extended JGTRRA's dividend and capitals gains rate cuts along with its AMT reduction. The dividend and capital gains cuts were extended through 2010; the increased AMT exemption through 2006.

Notwithstanding the various extensions and accelerations, the issue of EGTRRA's scheduled expiration at the end of 2010 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.

Tax Administration: The Tax Gap and Tax Shelters

Given congressional interest both in revenue-reducing measures (for example, scaling back the AMT) and concern about the federal budget deficit, it appears likely that policymakers will also focus attention on possible revenue-raising measures that would, in effect, help pay for tax-cuts elsewhere. One possible area is tax administration; in the Senate Finance Committee, leaders from both parties have expressed interest in closing the "tax gap" and in possibly restricting "tax shelters."

The "tax gap" and "tax shelter" concepts are closely related, but not synonymous, so clarification is useful. The tax gap is a concept defined by the Internal Revenue Service for use in administering the tax code — it is the difference between the amount of tax voluntarily and timely paid by taxpayers and the actual tax liability of taxpayers. The tax gap thus includes both deliberate (and illegal) tax evasion and non-payment that occurs for more innocent reasons: for example, taxpayer error or simple inability to pay. The concept of "tax shelter" is less precisely defined, but is generally an economic concept (though whether to make it a legal one as well is, in fact, an issue that has been debated in congress and elsewhere). A tax shelter is tax-planning device that individual or corporate taxpayers use to either illegally evade or legally avoid taxes in ways that were not intended by policymakers.

The Tax Gap. Leaders of both tax-writing committees have expressed interest in looking for ways to reduce the tax gap. Congressional interest appears to be especially high in the Senate Finance Committee, which conducted hearings on the tax gap in July 2006, and where the gap has been an issue in the confirmation of Eric Solomon to be Assistant Secretary of the Treasury for Tax Policy.[17] In its most recent report on the gap, the IRS estimated its size was $345 billion for tax year 2001 — an amount equal to 16.3% of taxes actually owed and somewhat larger than the $260 billion federal budget deficit projected for FY2006.[18]

As defined by the IRS, the tax gap consists of three components: nonfiling (failure to file a return), underreporting (understating income or overstating deductions), and underpayment (failure to pay reported taxes owed). Of these, underreporting is by far the largest, comprising 83% of the total gap, with

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[17] Allen Kenney, "Treasury Releases Tax Gap Plan; Solomon Nomination Still in Limbo," *Tax Notes*, Oct. 2, 2006, p. 10. Senator Baucus has stated that closing the tax gap "is a passion of mine" (news release by Senator Baucus dated July 10, 2006; available at the Finance Committee website visited Nov. 29, 2006, at [http://finance.senate.gov/hearings/statements/071306MB.pdf].

[18] U.S. Internal Revenue Service, IRS Updates Tax Gap Estimates, news release IR-2006-28, Feb. 14, 2006. Available (along with a variety of other publications about the tax gap) on the IRS website, at [http://www.irs.gov/newsroom/article/0,,id=158619,00.html].

underpayment making up 10% and nonfiling 8%. Among the different tax categories, the largest component of the gap was, by far, the individual income tax, accounting for 71% ($245 billion) of the total, followed by employment taxes (17%, or $59 billion), corporate income tax (9%, or $32 billion), and estate taxes (2%, or $8 billion). Within the individual income tax category, the largest component consisted of underreported business income (55%, or $109 billion).[19]

Proposals to reduce the tax gap have included both changes in the tax law and changes in IRS tax administration. Congress may thus address the issue either through its oversight or legislative functions. Legislatively, the staff of the Joint Committee on Taxation (JCT) has issued two reports outlining numerous legislative approaches for reducing the tax gap.[20] The reports contain proposals aimed at restricting tax shelters and closing perceived "loopholes," as well as measures that would address non-compliance by other means, including simplification and/or clarification of tax laws, increased withholding, and increased information reporting. A number of the reports' proposals were included as revenue-raising measures in the Tax Increase Prevention and Reconciliation Act of 2006; it thus appears likely that if additional legislation is considered to address the tax gap, it may include items from the JCT report.

In September 2006, the Department of the Treasury's Office of Tax Policy issued a report outlining a strategy for reducing the tax gap.[21] Although the report was lacking in specifics and contained only preliminary information in some areas, it listed a number of different ways in which the IRS might attempt to reduce the tax gap, including strengthening reporting requirements, making efforts to enhance access to data, enhancing examination and collection authority, revising penalties, issuing addition regulations and guidance for taxpayers, increasing research, improving information technology, and establishing more efficient compliance activities.

The report also, however, argued that a component of reducing the tax gap should be reduction in tax-code complexity, which, in the words of the report, "makes the tax law too difficult for taxpayers to understand and for the IRS to administer." It also stated that "enforcement activities should be combined with a commitment to taxpayer service," and that compliance proposals "should be sensitive

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[19] The figures reported here are from the IRS website, at [http://www.irs.gov/pub/irs-news/tax_gap_figures.pdf], visited Nov. 29, 2006.

[20] The first report was U.S. Congress, Joint Committee on Taxation, *Options to Improve Tax Compliance and Reform Tax Expenditures*, JCS-02-05, Jan. 27, 2005. Available on the Committee's website, at [http://www.house.gov/jct/pubs05.html]. The second was the Joint Committee's Additional Options to Improve Compliance, Aug. 3, 2006, and is available as a Tax Core feature of BNA's *Daily Tax Report* for Oct. 20, 2006.

[21] U.S. Department of the Treasury, Office of Tax Policy, *A Comprehensive Strategy for Reducing the Tax Gap* (Washington, Sept. 26, 2006). The report is available on the Office of Tax Policy's website, at [http://www.treas.gov/offices/tax-policy/] (visited Nov. 30, 2006). The report had been requested by Senator Baucus in February, 2006. See Martin A. Sullivan, "Lessons for Congress on Closing Loopholes," *Tax Notes*, Mar. 6, 2006, p. 1024.

to taxpayer rights and maintain an appropriate balance between enforcement activity and imposition of taxpayer burden."[22]

The Treasury Department's qualifications illustrate what is probably the chief policy issue related to the tax gap — the question of how vigorously to address it. There are few policymakers or tax analysts who object — in principle — to the idea of reducing the tax gap. In broad terms, non-compliance not only reduces federal revenues directly (and can thus be viewed as contributing to the budget deficit), the gap also damages the perceived fairness of the tax system on the part of taxpayers who are compliant. Beyond the agreement in principle, however, there are disagreements over the extent to which concerns about taxpayer rights and the overall level of tax burdens should mitigate efforts to shrink the tax gap.

Tax Shelters. In popular usage, the term "tax shelter" denotes the use of tax deductions or credits from one activity to reduce taxes on another. In economic terms, a tax shelter can be defined as a transaction (for example, a paper investment or sale) that reduces taxes without resulting in a reduced return or increased risk for the participant.[23] But so vague and general is the term in most usages, that it could also be defined simply as a tax saving activity that is viewed as undesirable by the person or agency observing the activity and using the term.

Tax shelters can be either legal (tax "avoidance") or illegal (tax "evasion"). To the extent tax shelters are illegal, they therefore contribute to the tax gap; to the extent that they are legal but unintended uses of the tax law ("loopholes"), they reduce tax revenue beyond the loss caused by the tax gap. Like the tax gap, tax shelters not only reduce tax revenue directly, but raise questions about tax fairness among taxpayers not using shelters. In addition, while some shelters lack economic substance, others involve the actual shifting of economic resources solely for the purpose of saving taxes, and may thus reduce economic efficiency.

Congress has evinced considerable interest in tax shelters in recent years and has enacted some restrictions into law. The American Jobs Creation Act of 2004 (AJCA; P.L. 108-357) contained a number of provisions designed to restrict tax shelters. In part, the act's provisions were directed at specific tax shelters — for example, leasing activities and the acquisition of losses for tax purposes ("built in" losses). In addition, the act included provisions — for example, revised penalties and reporting requirements — designed to restrict sheltering activity in general.[24] In 2006, the Senate version of TIPRA contained a number of tax shelter restrictions, but the provisions were not included in the conference committee bill. Prominent among the provisions was what the bill termed a "clarification" of the economic substance doctrine that has been followed in a number of court decisions related to tax shelters.

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[22] U.S. Treasury, Office of Tax Policy, *A Comprehensive Strategy for Reducing the Tax Gap,* p. 2.

[23] These definitions are taken from Joseph J. Cordes and Harvey Galper, "Tax Shelter Activity: Lessons from Twenty Years of Evidence," *National Tax Journal*, vol. 38, Sept., 1985, pp. 305-320.

[24] For a list and description, see CRS Report RL32193, *Anti-Tax-Shelter and Other Revenue-Raising Tax Proposals Considered in the 108th Congress*, by Jane G. Gravelle.

Generally, the economic substance doctrine disallows tax deductions, credits, or similar benefits in the case of transactions determined not to have economic substance. The Senate version of TIPRA would have integrated aspects of the doctrine into the tax code itself. A similar measure was contained in the Senate version of the AJCA, but was not adopted, and given the relatively large revenue estimates associated with the measure — the Joint Tax Committee estimated that the Senate's 2006 provision would increase revenue by $15.8 billion over 10 years — it is possible that the economic substance doctrine will again receive congressional attention in the 110th Congress.

International Taxation

There are some indications that Congress may include the tax treatment of U.S. firms' foreign income in any search for additional tax revenue. For example, during the summer of 2006, Democratic leaders included a call to "end tax breaks that reward companies for moving American jobs overseas" in the general policy agenda they outlined in the lead-up to the mid-term elections.

Economic theory is skeptical about whether tax policy towards U.S. multinationals can have a long-term impact on domestic employment, although short-term and localized impacts are certainly possible. Taxes can, however, alter the extent to which firms engage in overseas operations rather than domestic investment. Under current law, a tax benefit known as "deferral" poses an incentive for U.S. firms to invest overseas in countries with relatively low tax rates. In general terms, deferral permits U.S. firms to indefinitely postpone U.S. tax on their foreign income as long as that income is reinvested abroad in foreign subsidiaries. Deferral is generally available for active business operations abroad, but the tax code's Subpart F provisions restrict deferral in the case of income from passive investment. If made, proposals to restrict deferral may consist of expansion in the range of income subject to Subpart F.

In recent years, however, the thrust of legislation has been more in the direction of expanding deferral and cutting taxes for overseas operations than for expanding Subpart F. For example, the American Jobs Creation Act of 2004 cut taxes on overseas operations in several ways, while in 2006, TIPRA restricted Subpart F in the case of banking and related businesses receiving "active financing" income and in the case of the "look through" treatment overseas operations receive from other firms (see also the discussion of TIPRA, below). Further, several analysts have recently argued that attempts to tax overseas operations are either counter-productive or outmoded in the modern integrated world economy. (Traditional economic analysis, however, suggests that overseas investment that is taxed at a lower or higher rate than domestic income impairs economic efficiency.)

Budget "PAYGO" Rules

There is some interest in Congress in adopting budget rules that would place new limits on tax cuts and direct spending outlays that increase the federal budget deficit, and the House took action on such rules in the first week of the new session.[25] Such action, while not directly altering tax policy, has the potential of altering the context in which tax policy is considered and could alter both the size and content of tax legislation.

According to some observers, "pay-as-you-go" (PAYGO) budget rules (now lapsed) that were enacted in 1990 made an important contribution to the federal budget surpluses that occurred in FY1998-FY2001 after decades of deficits.[26] (The rules were provided by the Budget Enforcement Act: BEA, Title XIII of P.L. 101-508, the Omnibus Budget Reconciliation Act of 1990.) Under the PAYGO rules, if legislation enacted over the course of a session were to result in a net increase in the budget deficit, across-the-board spending cuts (sequestration) by the President would be triggered to offset the increased deficit. The initial rules were temporary, but were extended in 1993 and 1997 before terminating in December 2002.

A procedural rule similar to the statutory PAYGO requirement aimed at restricting budget deficits has continued to apply in the Senate. Under the Senate rule, consideration of tax and direct spending legislation is prohibited if the measure would increase the budget deficit during several specified periods (the first fiscal year, the first five fiscal years, and the following five fiscal years). However, tax cuts and spending increases assumed in the budget resolution are exempt from the requirement.

Proposals have been made to either reinstate the lapsed PAYGO rules that were enforced by sequestration, to remove the exemption for budget policies assumed in the budget resolution from the current Senate PAYGO rule, or to apply a rule similar to the current Senate rule in the House.[27] On January 5, 2007, the House approved H.Res. 6, which—among other provisions—implemented PAYGO rules for the House. Along with spending restrictions, the rules provide that it is not in order to consider tax legislation that would either increase the budget deficit or reduce a budget surplus over specified periods, including the current fiscal year, the first five fiscal years, or the first 10 fiscal years. In contrast to the current Senate rule, the House PAYGO rule does not exclude tax cuts assumed in the budget resolution.

For additional information, see CRS Report RL32835, *PAYGO Rules for Budget Enforcement in the House and Senate*, by Robert Keith and Bill Heniff, Jr.

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[25] Steven T. Dennis, "Democrats' First 100 Hours: Costly AMT Rewrite an Opening Challenge to Anti-Deficit Goals," *CQ Weekly*, Nov. 20, 2006, p. 3107.

[26] Rudolph G. Penner, "Can Congress Use Budget Rules to Improve Tax Policy?" *Tax Notes*, Oct. 23, 2006, p. 377.

[27] Former Congressional Budget Office director Rudolph Panner has pointed out that while the sequestration rules were effective, they never required deficit reduction — they only applied to increases in the budget deficit. However, because the alternative minimum tax may gradually increase tax liabilities, PAYGO rules would block AMT relief if it were not accompanied by offsets. In that instance, PAYGO rules would act to actually reduce the budget deficit below what would otherwise occur — an effect that Penner believes would be more painful than occurred in the past under the expired PAYGO rules. Ibid., p. 377.

Recently Enacted Tax Legislation

Tax Relief and Health Care Act of 2006 (TRHCA; P.L. 109-432)

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

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 held to be 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 section). However, Congress returned to the extenders in its post-election session. On December 9 the Senate approved an extenders bill (H.R. 6111) that had been passed by the House on December 8. The bill was estimated to reduce tax revenue by $38.1 billion over five years and $45.1 billion over 10 years. It was signed into law as the Tax Relief and Health Care Act of 2006 (P.L. 109-432).

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

- Deduction of tuition
- New markets tax credit
- Deduction of state & local sales taxes
- Research and experimentation tax credit
- Work opportunity and welfare-to-work tax credits (combined)
- Earned income tax credit treatment of combat pay
- Qualified zone academy bonds
- Deduction of teacher expenses
- Expensing of brownfields costs
- DC investment incentives
- Indian employment credit
- Depreciation on Indian reservations
- Leasehold depreciation
- Rum excise cover-over to Puerto Rico and Virgin Islands
- Parity in application of mental health benefits
- Charitable contributions of scientific and computer property
- Medical savings accounts
- Suspended limit on percentage depletion
- Economic development credit for American Samoa
- Gulf Opportunity Zone depreciation
- Authority for undercover operations
- Disclosures of certain tax return information

Tax Increase Prevention and Reconciliation Act (TIPRA; P.L. 109-222)

In terms of its revenue impact and scope, the largest tax bill enacted during 2006 was the Tax Increase Prevention and Reconciliation Act (TIPRA; P.L. 109-222). The final version of the bill was estimated to reduce taxes by $70 billion over 10 years — a reduction whose size was modest compared to a number of other tax bills enacted in 2001, 2003, and 2004.

The chief elements of TIPRA were extension of two temporary provisions contained in earlier tax-cut bills: reduced rates for capital gains and dividends, and an increased AMT exemption. As described above, the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA) reduced the tax rate on both capital gains and dividends to 15% (5% for income in the 15% and 10% regular-income brackets), but scheduled its reductions to expire at the end of 2008. Absent an extension, the capital gains rate would have reverted to prior law's 20% rate (10% for income in the lowest brackets) and dividends would have been subject to the tax rates applicable to regular income, which range from 10% to 35%. TIPRA extended the reduced dividend and capital gains rates for two years, through 2010.

As described above, Congress enacted temporary increases in the AMT exemption in 2001 and 2003 under EGTRRA, and JGTRRA, respectively. In 2004, WFTRA extended through 2005 an exemption amount of $58,000 for married couples and $40,250 for single filers. TIPRA extended the increased exemption for one year. Under its provisions, 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.

TIPRA also extended for two years (through 2009) an increased "expensing" allowance for small business investment in machines and equipment; under TIPRA, the maximum expensing allowance is $100,000. (Absent its extension the allowance would have reverted to $25,000.) In addition, TIPRA extended for two years (through 2008) more generous rules for the "active financing income" of U.S. multinational firms. The act also contained a number of revenue-raising items. Among the most prominent was a scaling-back of the exclusions for foreign earned income and housing (provided by section 911 of the tax code) and a new requirement for withholding by payments made by state and local government entities to contractors.

The conference agreement on TIPRA differed in important respects from both the House and Senate bills. The House bill, but not the Senate bill, contained the extended capital gains and dividend rates; the Senate bill, but not the House bill, contained extension of the increased AMT exemption. As described above, TIPRA contained both. At the same time, however, both the House and Senate bills contained extension of numerous expiring tax provisions ("extenders") beyond the several measures that were ultimately enacted; the bulk of the extenders were dropped from the conference bill. (For more on the extenders, the section above, on page 7.)

Economic Growth Tax and Relief Reconciliation Act of 2001 (EGTRRA; P.L. 107-16)

EGTRRA was the first and largest of the several tax cuts enacted during the Bush Administration. It was signed into law on June 7, 2001, and has been estimated to have reduced revenue by an average of 0.71% of GDP per year over its first four years, and by 3.6% of revenues that would otherwise have been collected. In general, its tax cuts were chiefly in individual income taxes and estate taxes, and the reductions tended to be relatively broad in scope rather than tightly targeted to particular activities or investments. The chief reductions were:

- a phased-in reduction in statutory individual income tax rates;
- an increase in the per-child tax credit;
- several tax reductions for married couples;
- phase-out of the estate tax; and
- temporary reduction of the individual alternative minimum tax (AMT).

As discussed elsewhere in this report, to conform to a Senate procedural rule, EGTRRA's tax cuts were scheduled (under the act's own terms) to expire at the end of 2010.

Job Creation and Worker Assistance Act of 2002 (JCWA; P.L. 107-147)

The final version of the Job Creation and Worker Assistance Act was signed into law in March, 2002, but the act grew out of tax proposals that began moving through both chambers in late 2001 — proposals designed to provide economic stimulus in the wake of the September 2001 terrorist attacks. The enacted version of JCWA was considerably smaller than EGTRRA; the Joint Tax Committee estimated that it would reduce revenue by an estimated $12.9 billion over 10 years. Also in contrast to EGTRRA, the enacted version of JCWA focused more on business tax cuts than tax cuts for individuals.

The act's principal components were:

- A "bonus" depreciation allowance under which firms could deduct an additional 30% of the cost of property in its first year of service. The provision was temporary and limited to property placed in service before 2005.
- An extension of the net operating loss "carryback" period (the years in the past from whose income a firm can deduct losses) to five years from two years. The provision only applied to losses in 2001 and 2002.
- A set of business tax benefits targeted at areas of New York City.
- Extension of a set of expiring tax benefits (e.g., the work opportunity tax credit, the welfare-to-work tax credit, and extension of nonrefundable credits to the alternative minimum tax), generally through 2003.

The Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA; P.L. 108-27)

On January 7, 2003, President Bush announced the details of a new tax cut proposal intended to provide a stimulus to the economy and new tax incentives in selected areas. According to the Joint Committee on Taxation, the revenue reduction from the plan was estimated at $1.575 trillion over 10 years. The stimulus portion of the proposal consisted primarily of acceleration of several tax cuts for individuals that were enacted by EGTRRA in 2001 but that were scheduled to be phased in only gradually (see the preceding section on EGTRRA). Another prominent part of the President's 2003 plan was a proposal to move toward "integration" of the taxation of corporate-source income by cutting taxes on dividends and capital gains. The Administration also proposed to increase the "expensing" allowance for small business investment in equipment. Prominent among the more targeted tax cuts proposed with the budget were two new tax-favored savings vehicles that would replace Individual Retirement Accounts (IRAs) and that would have less binding restrictions than current law's IRAs as well as a set of new tax incentives for charitable giving.

On May 23, 2003, the House and Senate agreed to the conference report for H.R. 2, the Jobs and Growth Tax Relief and Reconciliation Act (JGTRRA; P.L. 108-27). In broad outline, the act contained the principal elements of the stimulus part of the President's tax-cut proposal. The President signed the bill into law on May 28. JGTRRA's conference agreement contained an estimated $350 billion in reduced revenues and increased outlays from FY2003 through FY2013, including $320 billion in tax cuts and $30 billion in outlay increases. The principal outlay provisions in the package established a $20 billion fund to provide fiscal relief to state governments. The principal tax components of JGTRRA were:

- Acceleration to 2003 of the individual income tax cuts enacted and scheduled for phase-in under EGTRRA.

- EGTRRA had scheduled a gradual increase in the child tax credit from prior law's $500 to a level of $1,000 by 2010. JGTRRA provided for the $1,000 to be effective in 2003 and 2004, but its acceleration was temporary and provided for the credit to revert in 2005 to the lower, phase-in schedule provided by EGTRRA ($700 in 2005 - 2008, $800 in 2009, and $1,000 in 2010).
- For 2003 and 2004 only, the standard deduction and 15% tax bracket for married taxpayers were made twice those for singles. In a manner similar to the child credit, these provisions were scheduled to revert to EGTRRA's schedule beginning in 2005.
- The alternative minimum tax exemption amount was increased by $9,000 for married couples and $4,500 for singles for 2003 and 2004.
- The maximum expensing benefit for small business investment was temporarily increased from prior law's $25,000 to $100,000 for 2003, 2004, and 2005. The provision's phase-out threshold was increased from $200,000 to $400,000 over the same time period.
- The temporary "bonus" depreciation allowance originally passed in March 2002 was increased and extended to allow for a 50% first year deduction (up from 30%) for the period between May 5, 2003, and December 31, 2004.
- The conference agreement reduced the tax rate on both dividends and capital gains to 15% for taxpayers in the higher tax brackets and 5% for those in the lower tax brackets for 2003 through 2008. (The tax rate for those in the lower tax brackets would be 0% in 2008.) The dividend provision was applied to both domestic and foreign corporations.

For additional information, see CRS Report RL31907, *The 2003 Tax Cut: Proposals and Issues,* by David L. Brumbaugh and Don C. Richards.

Working Families Tax Relief Act of 2004 (H.R. 1308; P.L. 108-311)

The Economic Growth and Tax Relief and Reconciliation Act of 2001 (EGTRRA) provided a number of substantial tax cuts that were scheduled to be phased in gradually over the 10 years following EGTRRA's enactment. As discussed more fully above (see the section on "Scheduled Expiration of Tax Cuts") the tax cuts are generally scheduled to expire at the end of 2010. In 2003, the Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) accelerated a number of EGTRRA's phased-in tax cuts, including reduction of individual income tax rates and tax cuts for married couples and families, making EGTRRA's cuts fully effective in 2003. However, JGTRRA's accelerations were themselves scheduled to expire at the end of 2004. A principal thrust of the Working Families Tax Relief Act (WFTRA) was to extend JGTRRA's tax cuts for varying lengths of time. The measure was approved by Congress on September 23, 2004, and was signed into law on October 4. According to Joint Tax Committee revenue estimates, WFTRA will reduce revenue by $132.8 billion over five years and $146.9 billion over 10 years.

WFTRA's provisions:

- extended the increased ($1,000) child tax credit through 2009;

- extended tax cuts for married couples through 2008;
- extended the widened 10% tax-rate bracket through 2010;
- extended the increased alternative minimum tax exclusion through 2005;
- accelerated the refundability of the child tax credit to 2004; and
- included combat pay in income that qualifies for the refundable child tax credit and the earned income tax credit.

In addition to the expiring provisions of EGTRRA and JGTRRA, the tax code has long contained a set of additional temporary tax benefits that are generally designed to promote various types of investments and activities thought to be beneficial. (See the above section on the "extenders.")

The American Jobs Creation Act (H.R. 4520; P.L. 108-357)

Congress passed the American Jobs Creation Act (AJCA) in October 2004. The principal concern of the bill was business taxation. The bill began as a remedy to a long-running dispute between the United States and the European Union over the U.S. extraterritorial income exclusion (ETI) tax benefit for exporters. The scope of the enacted bill, however, was considerably broader. In general outline, the act repealed ETI while implementing a mix of tax cuts for both domestic and multinational U.S. businesses. The act achieved estimated revenue neutrality with a set of provisions generally in the area of corporate tax compliance.

AJCA provisions are numerous and apply to a broad array of tax code sections. In general terms, however, the act's most important provisions were:

- a repeal of the ETI export tax benefit;
- a variety of tax cuts generally favoring domestic (as opposed to foreign) investment. (Chief among these was a new 9% deduction limited to domestic production.)
- several tax cuts for multinational firms, including more generous foreign tax credit rules for the treatment of interest expense and a consolidation of the several separate foreign tax credit limitations that existed under prior law.
- a set of revenue raisers (in addition to ETI's repeal), including provisions aimed at restricting corporate tax shelters, provisions designed to improve fuel tax compliance, and a provision restricting tax benefits available from lease transactions involving tax-indifferent entities.

For additional information on AJCA, see CRS Report RL32652, *The 2004 Corporate Tax and FSC/ETI Bill: The American Jobs Creation Act of 2004*, by David L. Brumbaugh.