

Committee on Ways and Means

The Estate Tax and Extension of Tax Relief Act of 2006

Detailed Summary

OVERVIEW

The *Estate Tax and Extension of Tax Relief Act of 2006* provides permanent estate and gift tax relief, extension of certain tax relief provisions through 2007, other tax relief provisions and an increase in the Federal minimum wage.

PERMANENT ESTATE AND GIFT TAX RELIEF

The *Estate Tax and Extension of Tax Relief Act of 2006* provides **permanent** estate and gift tax relief. Under current law, the estate tax relief provided in the *Economic Growth and Tax Relief Reconciliation Act of 2001* (EGTRRA) will end in 2010. Unless Congress acts, in 2011 the estate tax exemption will drop to \$1 million per person and the maximum estate tax rate will increase to 55 percent.

1. Unified Estate, Gift and Generation-Skipping Transfer Tax

The provision reunifies the estate, gift and generation skipping transfer taxes – giving individuals greater flexibility to make estate planning decisions during life. A non-unified estate and gift tax provides less favorable tax treatment for gifts made during lifetime than gifts made (through a will) at death.

2. Increased Estate and Gift Tax Exemption

The provision phases-in an increased exemption amount to \$5 million per person (indexed for inflation). The \$5 million per person exemption amount is fully phased-in effective January 1, 2015.

3. Lower Estate and Gift Tax Rates

The provision reduces the tax rate on amounts up to \$25 million (indexed for inflation) to the capital gains tax rate (currently 15 percent, set to increase to 20 percent in 2011 unless extended). The provision also phases-in a reduced tax rate on amounts in excess of \$25 million (indexed for inflation) to 30 percent. The 30 percent tax rate is fully phased-in effective January 1, 2015.

4. Portable Spousal Estate and Gift Tax Exclusion Amount

The provision simplifies estate tax planning by allowing married couples to take full advantage of the \$5 million per person exemption amount (indexed for inflation) by carrying over any unused exemption to the surviving spouse, subject to the phase-in of the exemption amount.

5. Guarantees “Stepped-Up” Basis

The provision maintains “stepped-up” basis for property acquired from a decedent by repealing the modified carryover basis rules under EGTRRA that would have gone into effect in 2010.

EXTENSION AND MODIFICATION OF CERTAIN PROVISIONS

The *Estate Tax and Extension of Tax Relief Act of 2006* extends through 2007, and in certain circumstances modifies, provisions which either expired at the end of 2005 or will expire at the end of 2006.

1. Above-the-Line Deduction for Higher Education Expenses

The provision allows taxpayers to deduct up to \$4,000 (depending on their income) of higher education expenses in lieu of claiming the Hope or Lifetime Learning tax credits. The deduction may be claimed by all individual taxpayers regardless of whether they itemize their deductions. The provision is extended for two years through 2007.

2. Extension and Modification of the New Markets Tax Credit (NMTC)

The NMTC provides a tax credit to taxpayers who invest in businesses which are located in qualified low-income neighborhoods. The provision extends the NMTC for one year. The provision also requires that the Secretary prescribe regulations to ensure that non-metropolitan counties receive a proportional allocation of qualified equity investments.

3. State and Local Sales Tax Deduction

The provision creates parity among States by allowing all taxpayers the option to deduct their State and local sales taxes in lieu of their State and local income taxes. The provision is extended for two years through 2007.

4. Extension and Modification of the Research and Development (R&D) Tax Credit

The provision extends the R&D tax credit for two years through 2007. In addition to the extension, effective January 1, 2007, the provision increases the value of the alternative incremental credit and adds a new alternative simplified credit.

5. Work Opportunity Tax Credit (WOTC)

Employers may claim the WOTC if they hire individuals from groups that are considered to face barriers to employment. The maximum credit is \$2,400 and may be claimed during the individual’s first year of employment. The provision extends the current WOTC without modification through 2006. Beginning in 2007, the provision combines the WOTC with the Welfare-to-Work (WTW) credit and extends the combined provision through 2007. Key modifications of the combined credit include expanded eligibility for WOTC (raised age ceiling for food stamp recipients from 25 to 40), revised eligibility requirements for ex-felons (without

regard to family income) and a modification of the filing deadline for WOTC claimants from 21 to 28 days.

6. Welfare-to-Work (WTW) Tax Credit

Employers may claim the WTW tax credit if they hire individuals who have received public assistance for an extended period of time. The maximum credit is \$3,500 during the employee's first year of employment and \$5,000 during the second year. The provision extends the WTW credit through 2007 and combines it with the WOTC credit after 2006.

7. Treating Combat Pay as Earned Income Under the Earned Income Credit

The provision provides that military personnel have the option of including combat pay in the earned income credit calculation. The provision is extended for one year through 2007.

8. Authority to Issue Qualified Zone Academy Bonds (QZABs) for School Modernization

QZABs are tax credit bonds which are issued by States and local governments to help repair schools, purchase school equipment and train teachers in economically distressed areas. The provision is extended for two years through 2007. The provision also imposes a new requirement that the issuer reasonably expects to and actually spends 95 percent of the proceeds from the sale of QZABs on QZAB property within five years of the date of issuance. The provision also contains new arbitrage rebate and information reporting requirements.

9. Above-the-Line Deduction for Teacher Classroom Expenses

The provision allows teachers to deduct up to \$250 of out-of-pocket costs incurred to purchase books, supplies and other classroom equipment. The deduction is available to all individual taxpayers regardless of whether they itemize their deductions. The provision is extended for two years through 2007.

10. Brownfields Expensing

Taxpayers may expense costs incurred in cleaning up certain contaminated sites. The deduction may be claimed against regular tax and the alternative minimum tax (AMT). The provision is extended for two years through 2007. The provision also expands the definition of an eligible contaminated site to include sites contaminated by petroleum products.

11. Tax Incentives to Revitalize the District of Columbia

Certain economically distressed areas in the District of Columbia are designated as the "D.C. Enterprise Zone." To help encourage development, certain tax benefits are available to eligible businesses in the D.C. Enterprise Zone, such as zero capital gains rates. In addition, first-time homebuyers in D.C. (not limited to the D.C. Enterprise Zone) may claim a tax credit of up to \$5,000 on the purchase price of the home. The provision is extended for two years through 2007.

12. Tax Incentives for Business Activity on Indian Reservations

a. Employment Tax Credit

Employers receive a 20-percent tax credit on the first \$20,000 of wages and employee health insurance costs paid to individuals who live on or near Indian reservations to the extent these costs exceed the employer's costs in the baseline year of 1993. The provision is extended for two years through 2007.

b. Accelerated Depreciation

Businesses located on Indian reservations benefit from accelerated depreciation schedules for property that is primarily used to conduct business on the reservation. The provision is extended for two years through 2007.

13. Fifteen-Year Depreciation for Leasehold Improvements

The cost of leasehold improvements is generally depreciated over 39 years. The provision reduces the depreciation period for leasehold improvements from 39 years to 15 years. The provision is extended for two years through 2007.

14. Fifteen-Year Depreciation for Restaurant Improvements and New Restaurant Properties

The cost of nonresidential real property is generally depreciated over 39 years. The provision (i) extends a reduced 15-year depreciation period for restaurant improvements to existing restaurant properties through 2007, and (ii) expands the provision to include new restaurant properties placed in service after the date of enactment of the bill and before the end of 2007.

15. Transfer of Rum Excise Taxes to Puerto Rico and the Virgin Islands

Distilled spirits are subject to an excise tax equal to \$13.50 per-proof-gallon. Of the total amount collected on imported rum, \$13.25 per-proof-gallon is transferred to Puerto Rico and the Virgin Islands. The provision is extended for two years through 2007.

16. Excise Tax for Enforcing Mental Health Parity Rules

Group health plans that provide both medical benefits and mental health benefits are not allowed to impose dollar limits on the mental health benefits if the same limits are not also imposed on medical benefits. In general, employers who violate this rule are subject to a \$100 per day excise tax penalty (up to a cap) until the health plan is brought into compliance. The provision is extended for one year through 2007.

17. Enhanced Deduction for Certain Donations of Scientific Property and Computer Equipment

The provision allows corporations to claim an enhanced tax deduction equal to the lesser of basis plus half of the item's appreciation or twice basis for certain donations of certain constructed or

assembled scientific property and computer equipment. The provision with respect to donations of scientific property is permanent under current law. The provision with respect to computer donations is extended for two years through 2007.

18. Archer MSAs (Medical Savings Accounts)

Individuals may make tax-deductible contributions to an Archer MSA to pay for health care expenses. The distributions are tax-free if used to pay for eligible medical expenses. The provision is extended for two years through 2007.

19. Suspension of Limit on Percentage Depletion for Oil and Gas from Marginal Wells

Percentage depletion allows independent producers to deduct 15 percent of a marginal well's gross income each year, as long as the deduction does not exceed 100 percent of the well's net income in any year. The provision waives the 100 percent limitation so that independent producers may realize the full benefit of percentage depletion. The provision is extended for two years through 2007.

20. Economic Development Credit for American Samoa

The provision provides an economic development credit to certain possessions corporations operating in American Samoa. The provision is effective for two years.

21. New York Liberty Zone Incentives for Transportation Infrastructure

The provision restructures the New York Liberty Zone incentives in order to provide needed transportation infrastructure in that area. The provision repeals the remaining New York Liberty Zone incentives which include special bonus depreciation, accelerated leasehold improvement recovery, increased Section 179 expensing and the extended replacement period for involuntary conversions. The provision then provides a credit against withholding taxes payable by the City and State of New York. This credit of up to \$1.75 billion may be used to finance qualifying transportation projects in the City of New York.

22. Certain Gulf Opportunity Zone Bonus Depreciation

The provision modifies the bonus depreciation provision that was included in the *Gulf Opportunity Zone Act of 2005* by extending the placed-in-service deadline for certain property used in certain highly damaged areas within the Gulf Opportunity Zone.

23. Authority for IRS Undercover Operations

This provision provides the IRS with the authority to use income earned by an undercover operation to pay additional expenses incurred in such undercover operation. The provision is extended for one year through 2007.

24. Authority for the IRS to Disclose Certain Tax Information

These provisions provide that the IRS may share certain tax information with certain other Federal and/or State authorities in order to: (1) facilitate combined employment tax reporting, (2) investigate terrorist activities, and (3) facilitate the repayment of student loans that are contingent on income. Each of these provisions is extended for one year through 2007.

OTHER TAX PROVISIONS

1. Allow U.S. Businesses with Branches in Puerto Rico to Claim the Manufacturing Deduction

The provision allows U.S. businesses operating as branches in Puerto Rico to claim the domestic manufacturing deduction. The provision is effective for two years.

2. Incentive Stock Option AMT Provisions

The provision allows individuals to take advantage of a refundable credit with respect to certain long-term unused AMT credits existing prior to January 1, 2013. The annual credit amount, subject to a phase-out, is the greater of (i) the lesser of \$5,000 or the amount of the long-term unused AMT credit, or (ii) 20 percent of the amount of the long-term unused AMT credit.

3. Mine Safety Provisions

a. Partial Expensing for Advanced Mine Safety Equipment

This provision provides 50 percent expensing for certain equipment expenditures related to safety equipment for underground mines located in the United States. The provision is effective for three years through 2008.

b. Mine Rescue Team Training Tax Credit

This provision provides tax credits for certain mine rescue team training programs. The provision is effective for three years through 2008.

4. Whistleblower Reforms

The provision reforms the reward program for individuals who provide information to the Secretary regarding violations of the tax laws. The provision establishes a reward range for such "whistleblowers" of 15 percent to 30 percent of proceeds collected by the IRS (subject to certain exceptions) where the amount in dispute exceeds \$2,000,000. The provision also provides the Secretary with regulatory authority to create a Whistleblower Office within the IRS to administer the reward program.

5. Frivolous Tax Submissions

The provision increases the penalty for frivolous tax return submissions from \$500 to \$5,000 and expands the penalty to all taxpayers and all types of Federal taxes. This increased penalty also applies to frivolous submissions for lien and levy collection due process, installment agreements, offers-in-compromise and taxpayer assistance orders.

6. Meningococcal and Human Papillomavirus Vaccines

The provision adds the meningococcal and human papillomavirus vaccines to the list of taxable vaccines.

7. Permanency of Certain Provisions Enacted In the *Tax Increase Prevention and Reconciliation Act of 2005*

A number of provisions that were enacted on a temporary basis in the *Tax Increase Prevention and Reconciliation Act of 2005* are made permanent.

a. Tax Treatment of Environmental Cleanup Funds

The provision treats environmental cleanup settlement funds as governmentally-owned (i.e., not subject to tax) if certain standards and requirements are met.

b. Simplification of the Active Trade or Business Test

The provision simplifies the application of the active trade or business test to certain corporate distributions by applying this test on an affiliated group basis.

c. Enhancing Veterans' Access to Affordable Mortgages

The provision expands eligibility for the qualified veterans' mortgage bond program in a number of States by repealing the requirement that veterans must have served before 1977 and reducing the eligibility period from 30 years to 25 years.

d. Tax Treatment of Self-Created Musical Works

The provision provides capital gains treatment for self-created musical works when these works are sold by the artist.

e. Modification of the Tonnage Tax

The provision provides that U.S.-flagged vessels weighing more than 6,000 deadweight tons may elect into the alternative tonnage tax regime.

f. Tax Treatment of the Permanent University Fund

The provision provides an exception for a portion of the Permanent University Fund from the tax-exempt bond arbitrage rules. The Permanent University Fund is used to finance capacity-enhancing infrastructure at certain public universities.

8. Modification of the Tonnage Tax for Great Lakes Shipping

The provision permanently modifies the treatment of shipping within the Great Lakes to ensure that vessel operators in this region can qualify for the alternative tonnage tax regime.

9. Modification of the Mortgage Revenue Bond Rules for Veterans

The provision makes affordable mortgages more accessible to veterans by providing them with a one-time exception from the mortgage revenue bond first-time homebuyer requirement. This provision applies to mortgage revenue bonds issued before January 1, 2008.

10. Sale of Residences by Intelligence Officers

The provision gives non-military intelligence officers parity with active military personnel for the capital gains exclusion on sales of homes provided such officers are stationed abroad. This provision applies to sales of homes before January 1, 2011.

11. Coke and Coke Gas Production Tax Credit

The provision eliminates the reference price phase-out provisions for the coke and coke gas production tax credit. The credit remains subject to the per-facility production caps.

12. Sale of Property by Certain Federal Judicial Officers

The provision provides special rollover rules for certain Federal judicial officers who sell property to comply with certain conflict-of-interest requirements.

13. Premiums for Mortgage Insurance

The provision establishes an itemized deduction for the cost of premiums for mortgage insurance on a qualified personal residence. The deduction is phased-out ratably by 10 percent for each \$1,000 by which the taxpayer's adjusted gross income exceeds \$100,000. The provision is effective for one year.

14. Refunds for Kerosene Used In Aviation

The provision modifies the refund rules with respect to kerosene used for certain exempt aviation purposes.

15. Qualified Timber Capital Gains

The provision creates a new 60 percent deduction for qualified timber capital gains. The provision is effective for qualifying gains recognized from the date of enactment through 2007.

16. Rural Renaissance Bonds

The provision authorizes the issuance of up to \$200 million of tax credit bonds to finance certain rural development projects.

17. Spousal Travel Deduction

The provision allows employers to deduct the cost of travel expenses incurred by an employee on behalf of a spouse accompanying the employee on business-related travel. The provision applies to expenses paid or incurred before January 1, 2008.

18. Technical Corrections

Technical corrections are made to the *Tax Increase Prevention and Reconciliation Act of 2005* and the *Gulf Opportunity Zone Act of 2005*.

OTHER PROVISIONS

1. Abandoned Mine Land (AML) Program

The provision modifies the Abandoned Mine Land (AML) program.

2. Increase in the Federal Minimum Wage and Tip Credit Fairness

The provision increases the current federal minimum wage rate of \$5.15 per hour by \$2.10 over three years in the following increments: \$5.85 an hour effective on January 1, 2007, \$6.55 an hour effective on June 1, 2008 and \$7.25 an hour effective on June 1, 2009. The provision also provides that tips may be counted towards meeting any future minimum wage increases by employers in those states where state law prohibits tips from being calculated as part of the minimum wage.