X. TAX COMPLEXITY ANALYSIS

The following tax complexity analysis is provided pursuant to section 4022(b) of the Internal Revenue Service Reform and Restructuring Act of 1998, which requires the staff of the Joint Committee on Taxation (in consultation with the Internal Revenue Service (''IRS'') and the Treasury Department) to provide a complexity analysis of tax legislation reported by the House Committee on Ways and Means, the Senate Committee on Finance, or a Conference Report containing tax provisions. The complexity analysis is required to report on the complexity and administrative issues raised by provisions that directly or indirectly amend the Internal Revenue Code and that have widespread applicability to individuals or small businesses. For each such provision identified by the staff of the Joint Committee on Taxation, a summary description of the provision is provided along with an estimate of the number and type of affected taxpayers, and a discussion regarding the relevant complexity and administrative issues.

Following the analysis of the staff of the Joint Committee on Taxation are the comments of the IRS and the Treasury Department regarding each of the provisions included in the complexity analysis, including a discussion of the likely effect on IRS forms and any expected impact on the IRS.

1. Reduction in income tax rates for individuals (sec. 101 of the conference agreement)

Summary description of provision

The bill creates a new 10-percent regular income tax bracket for a portion of the taxable income that is currently taxed at 15 percent. The bill reduces the other regular income tax rates. By 2006, the present-law individual income tax rates of 28 percent, 31 percent, 36 percent, and 39.6 percent are lowered to 25 percent, 28 percent, 33 percent, and 35 percent, respectively. The bill also provides for acceleration of the 10 percent income tax rate bracket benefit for 2001, principally through advance payment of the credit in the form of checks issued to taxpayers by the Department of the Treasury.

Number of affected taxpayers

It is estimated that the provision will affect approximately 100 million individual tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. It should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. It may, however, increase the number of questions that taxpayers ask the IRS, such as when taxpayers will receive their checks. This increased volume of questions could have an adverse impact on other elements of IRS' operations, such as the levels of taxpayer service. In addition, the provision should not increase the tax preparation costs for most individuals.

The IRS will need to add to the individual income tax forms package a new worksheet so that taxpayers can reconcile the amount of the check they receive from the Department of the Treasury with the credit they are allowed as an acceleration of the 10 percent income tax rate bracket benefit for 2001. This worksheet should be relatively simple and many taxpayers will not need to fill it out completely because they will have received the full amount by check.

The Secretary of the Treasury is expected to make appropriate revisions to the wage withholding tables to reflect the proposed rate reduction for calendar year 2001 as expeditiously as possible. To implement the effects of the rate cuts for 2001, employers would be required to use a new (second) set of withholding rate tables to determine the correct withholding amounts for each employee. Switching to the new withholding rate tables during the year can be expected to result in a one-time additional burden for employers (or additional costs for employers that rely on a bookkeeping or payroll service).

2. Standard deduction tax relief (sec. 301 of the conference agreement)

Summary description of provision

The bill increases the basic standard deduction for married taxpayers filing a joint return to twice the basic standard deduction for an unmarried individual. The increase is phased-in over five years beginning in 2005 and would be fully phased-in for 2009 and thereafter.

Number of affected taxpayers

It is estimated that the provision will affect approximately 23 million individual returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The higher basic standard deduction should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision. In addition, the provision should not increase individuals' tax preparation costs.

Some taxpayers who currently itemize deductions may respond to the provision by claiming the increased standard deduction in lieu of itemizing. According to estimates by the staff of the Joint Committee on Taxation, approximately three million individual tax returns will realize greater tax savings from the increased standard deduction than from itemizing their deductions. In addition to the tax savings, such taxpayers will no longer have to file Schedule A to Form 1040 and a significant number of which will no longer need to engage in the record keeping inherent in itemizing below-the-line deductions. Moreover, by claiming the standard deduction, such taxpayers may qualify to use simpler versions of the Form 1040 (i.e., Form 1040EZ or Form 1040A) that are not available to individuals who itemize their deductions. These forms simplify the return preparation process by eliminating from the Form 1040 those items that do not apply to particular taxpayers.

This reduction in complexity and record keeping also may result in a decline in the number of individuals using a tax preparation service or a decline in the cost of using such a service. Furthermore, if the provision results in a taxpayer qualifying to use one of the simpler versions of the Form 1040, the taxpayer may be eligible to file a paperless Federal tax return by telephone. The provision also should reduce the number of disputes between taxpayers and the IRS regarding substantiation of itemized deductions.

3. Expansion of the 15-percent rate bracket (sec. 302 of the conference agreement)

Summary description of provision

The provision increases the size of the 15-percent regular income tax rate bracket for married individuals filing a joint return to twice the size of the corresponding rate bracket for unmarried individuals. This increase is phased-in over four years beginning in 2005. It is fully effective beginning in 2008.

Number of affected taxpayers

It is estimated that the provision will affect approximately 20 million individual tax returns.

Discussion

It is not anticipated that individuals will need to keep additional records due to this provision. The increased size of the 15-percent regular income tax rate bracket for married individuals filing joint returns should not result in an increase in disputes with the IRS, nor will regulatory guidance be necessary to implement this provision.

4. Increase the child tax credit (sec. 201 of the conference agreement)

Summary description of provision

The provision increases the child tax credit from $500 to $1,000, phased in over an ten-year period beginning in 2001, extends refundability of the credit, allows the credit to the extent of the full regular tax and alternative minimum tax, and repeals the provision that reduces the refundable child credit by the individual's alternative minimum tax.

Number of affected taxpayers

It is estimated that the provisions will affect approximately 25 million individual tax returns.

Discussion

Individuals should not have to keep additional records due to this provision, nor will additional regulatory guidance be necessary to implement this provision. More taxpayers will have to perform the additional calculations necessary to determine eligibility for the refundable child credit but this should not lead to an increase in disputes with the IRS. For taxpayer's with less than two children, however, the provision can be expected to increase tax preparation costs and the number of individuals using a tax preparation service. (See, also, the discussion of the interactive effect of the child credit and the individual alternative minimum tax, below.)

5. The effect of the alternative minimum tax rules

The provisions relating to the rate reductions, increased standard deduction, the expanded 15-percent rate bracket, and the increased child tax credit are affected by the alternative minimum tax rules. Although the bill provides relief from the alternative minimum tax, additional individuals will need to make the necessary calculations to determine the applicability of the alternative minimum tax rules. It is estimated that for the year 2010, 18 million additional individual income tax returns that will benefit from the rate reductions, increased standard deduction, expanded 15-percent rate bracket, and increased child tax credit would be affected by the alternative minimum tax. For these taxpayers, it could be expected that the interaction of the provisions with the alternative minimum tax rules would result in an increase in tax preparation costs and in the number of individuals using a tax preparation service.

The bill also provides that the alternative minimum tax exemption amount for married individuals filing a joint return is increased. This should reduce complexity for affected taxpayers. It is estimated that, for the year 2006, the provision increasing the alternative minimum tax exemption amount will apply to seven million individual income tax returns. Some of these taxpayers will no longer be affected by the alternative minimum tax.

DEPARTMENT OF THE TREASURY,
INTERNAL REVENUE SERVICE,
Washington, DC, May 25, 2001.

Ms. LINDY L. PAULL,
Chief of Staff, Joint Committee on Taxation, Washington, DC.

DEAR MS. PAULL: Enclosed are the combined comments of the Internal Revenue Service and the Treasury Department on the provisions of the conference agreement on the "Economic Growth and Tax Relief Reconciliation Act." Our comments are based on the description of these provisions contained in a brief summary of the conference agreement prepared by the staff of the Joint Committee on Taxation.

Due to the short turnaround time, our comments are necessarily provisional.

Sincerely,

CHARLES O. ROSSOTTI.

Enclosure.

COMPLEXITY ANALYSIS OF ECONOMIC GROWTH AND TAX RELIEF RECONCILIATION ACT OF 2001

NEW 10-PERCENT RATE BRACKET AND REDUCTION IN OTHER RATE BRACKETS

Provision

Create a new 10-percent regular income tax bracket ($6,000/$10,000/$12,000 of taxable income in 2001–2007 and $7,000/$10,000/$14,000 of taxable income in 2008 and thereafter; index in 2009); advance payments would be made to taxpayers in 2001.

Reduce the present-law regular income tax rates of 28, 31, 36, and 39.6 percent to 25, 28, 33, and 35 percent, respectively. The reduction is phased in over 6 years beginning July 1, 2001.

IRS and Treasury Comments

The new tax bracket and the reduced tax rates would be incorporated into the tax table and the tax rate schedules shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR–EZ, and 1041, and on Forms W-4V and 8814 for 2001 and later years. Other forms (e.g., Form 8752 and Schedule D (Form 1040)) would also be affected. No new forms would be required.

The new tax bracket and the reduced tax rates would also be incorporated into the tax rate schedules shown on Form 1040–ES for 2002 and later years. Subsequent to enactment, the IRS would have to advise taxpayers who make estimated tax payments for 2001 how they can adjust their estimated tax payments for 2001 to reflect the reduced rates.

Programming changes would be required to reflect the new tax bracket and rates for tax years 2001 through 2006. Currently, the IRS tax computation programs are updated annually to incorporate mandated inflation adjustments. Programming changes necessitated by the provision would be included during that process for 2002 and later years. Supplemental programming changes would be required to accommodate the new 10-percent tax bracket for 2001.

New withholding rate tables and schedules will be published soon after enactment to update the current Circular E for use by employers during the remainder of calendar year 2001.

The advance payment of the credit for 2001 would require a notice to explain the advance payment amount; programming changes to compute the advance payment amount; and resources to answer taxpayer questions about the payment.

The new credit for 2001 would require a new form to report to taxpayers the amount of the advance payment made to them; one new line to be added to Forms 1040, 1040A, and 1040EZ for taxpayers to compute the amount, if any, of their allowable credit; programming changes to compute the amount of the credit; and script and other changes to enable TeleFile to compute the amount of the credit.

The alternative minimum tax (AMT) is projected to apply to an increasing number of taxpayers over time. The provision would increase the number of taxpayers particularly in the later years of the budget period (2006–2011), whose liability is affected by the AMT, and would also cause additional taxpayers to perform AMT calculation to determine whether their liability is affected by the AMT.

CHILD TAX CREDIT

Provision

Increase the amount of the child tax credit to $600 (2001–2004), $700 (2005–2008), $800 (2009), and $1,000 (2010).

Make the child tax credit refundable to the extent of 10 percent of the taxpayer's earned income in excess of $10,000 for 2001–2004 (15 percent for 2005 and later). The $10,000 figure would be indexed beginning in 2002.

Change the tax liability limitation for the child tax credit, including the order in which the credit is claimed, beginning in 2002. The child tax credit, but not the other personal nonrefundable credits, would be allowed against the sum of the regular tax and the alternative minimum tax. Under a new ordering rule, the foreign tax credit and the other nonrefundable personal credits would be taken into account before the child tax credit.

IRS and Treasury Comments

No new forms would be required as a result of any of the above-mentioned child tax credit provisions.

The increase in the amount of the child tax credit would be incorporated in the instructions for Forms 1040, 1040A, and 1040NR for 2001 and later years. This increase also affects the amount of the refundable child tax residents of Puerto Rico and would be reflected in the instructions for Forms 1040–PR and 1040–SS for 2001 and later years.

The change in the tax liability limitation for 2002 and later years would:

1. Eliminate two questions from the instructions for Forms 1040 and 1040A.

2. Eliminate the need to refer taxpayers with three or more qualifying children and certain other personal nonrefundable credits to Publication 972 to compute their child tax credit. Such taxpayers will no longer be required to complete an additional 10-line worksheet (the "Line 11 Worksheet") in Publication 972.

3. Add three lines to the child tax worksheet in the Form 1040 instructions and one line to that worksheet in the Form 1040A instructions.

4. Change the ordering of the credits on Forms 1040, 1040A, and 1040NR.

Nine million additional taxpayers would be required to file Form 8812 to benefit from the provision that would make the tax credit refundable to the extent of 15 percent of earned income in excess of $10,000. Form 8812 would be expanded from nine lines to 13 lines, beginning in 2001. (A similar change will be necessary on Forms 1040–PR and 1040–SS for resident of Puerto Rico.)

The increase in the amount of the credit would be incorporated on Form 1040–ES for 2004, 2007, 2010, and 2011.

Supplemental programming changes would be required to accommodate the changes to the computation of the child tax credit for 2001.

As a result of this change, the number of taxpayers affected by the AMT would decrease.

STANDARD DEDUCTION FOR MARRIED TAXPAYERS FILING JOINTLY

Provision

Increase the basic standard deduction for a married couple filing a joint return to twice the basic standard deduction for an unmarried individual filing a single return, phased in over 5 years beginning in 2006.

IRS and Treasury Comments

The increase in the basic standard deduction for married taxpayers would be incorporated in the instructions for Forms 1040, 1040A, 1040EZ, and on Forms 1040, 1040A, 1040EZ, and 1040-ES beginning in 2006. No new forms would be required.

Programming changes would be required to reflect the increased standard deduction for married taxpayers. Currently, IRS tax computation programs are updated annally to incorporate mandated inflation adjustments. Programming changes necessitated by this provision would be included during that process.

Compared with current law, the larger standard deduction would reduce the number of taxpayers who itemize deductions.

As a result of this provision, the number of taxpayers affected by the AMT would increase.

15-PERCENT RATE BRACKET FOR MARRIED TAXPAYERS FILING JOINTLY

Provision

Increase the width of the 15-percent regular income tax rate bracket for a married couple filing a joint return to twice the width of the corresponding rate bracket for an unmarried individual filing a single return, phased in over 5 years beginning in 2006.

IRS and Treasury Comments

The increase in the width of the 15-percent rate bracket for married taxpayers would be incorporated in the tax tables and the tax rate schedules shown in the instructions for Forms 1040, 1040A, 1040EZ, 1040NR, 1040NR-EZ, and on Form 1040-ES for each year during the phase-in period (2006–2010). No new forms would be required.

Programming changes would be required to reflect the expanded 15-percent rate bracket. Currently, the IRS tax computation programs are updated annually to incorporate mandated inflation adjustments. Programming changes necessitated by the provision would be included during that process.

As a result of this provision, the number of taxpayers affected by the AMT would increase.