COMMITTEE FOR A RESPONSIBLE FEDERAL BUDGET

ANALYSIS OF CANDIDATES' TAX PLANS and END OF THE SESSION MADNESS IN WASHINGTON

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Caution

To get any real sense of the potential impacts of policy change it is necessary to make projections several years into the future. But there is a difference between projected surpluses and money in the bank. The presidential campaigns have allocated huge amounts to tax cuts and spending increases, including big new/expanded entitlements,, that would eat up very nearly all projected non-Social Security Surpluses for a decade into the future. There are three problems with that approach. The surpluses might not be as big as current projections. The country could face new unanticipated needs. And we know that there will be tremendous budgetary pressures when the baby boom generation retires. Our last update said—and we repeat here—we would not cut taxes as much as the Bush campaign, nor increase spending as much as Gore campaign proposes. We would devote a larger share of short-term surpluses to debt reduction, preserving options, and laying the groundwork for major reforms that will be necessary over the longer term.

Correction

The Gore-Lieberman campaign has informed us that they count the cost of their Retirement Security Plus (RSP) proposal 80% tax cuts and 20% "in the form of refunds for people with no tax liability". We misunderstood, reversed the percentages, and counted 80% as outlays in our last update. If we adopted the Gore campaign scoring, our table would show total spending increase $1236 billion and tax cuts $480 billion. However, CBO counted 100% of the cost of a substantially similar Clinton Administration initiative as outlays. We think CBO is right. We did not raise the issue when we counted 80% of the cost of RSP as outlays. Given this change, however, it should be noted that we would characterize the RSP proposal as a large new entitlement program—rather than a tax cut. Obviously, the Gore campaign disagrees.

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Confusion

The Vice President says that the Bush-Cheney tax cut gives 42% of the money to the top 1% of taxpayers. That is an exaggeration. Joint Tax Committee (JTC) analysis suggests that people with incomes over $200,000 get 27% of the benefit. People with incomes over $100,000 get more than half the benefit. Most of the difference depends on how you treat estate tax relief. Table 1 is based on the JTC analysis. The JTC analysis is based on 2005 and does not include estate taxes. The Vice President bases his numbers on Citizens for Tax Justice, a self-identified liberal organization, projections over 11 years to capture the full phase-in of estate tax relief. That analysis attributes the entire cost of estate tax relief to the top 1% of taxpayers.

The Bush campaign says the lowest-income taxpayers get the largest percentage reductions under their proposal, because they drop the bottom rate from 15% to 10%, double the child credit, and apply the child credit to the alternative minimum tax. While those provisions account for about 50% of the cost of the Bush-Cheney proposal and would reduce taxes for all payers, the benefits diminish proportionately as you move up the income scale.

The Governor says that 50 million people would get no benefit at all from the Gore-Lieberman tax cut. The Gore-Lieberman campaign emphasizes the targeted nature of their tax cuts but does not say how many families or people would benefit—or be left out. Census data show 67 million people, in households with incomes of $79,000 or more, in 1999. Reviewing the income limits and other constraints on the Vice President's tax cuts (see Table 2) it is reasonable to conclude that 50 million people could fail to qualify.

The Governor's campaign criticizes the Gore-Lieberman tax proposals for extreme complexity, arguing that they would add many work sheets to the 1040, because of income phase-outs and other qualifying criteria. Further, many question how much revenue loss is needed to influence how many people to spend money on targeted goods and services.

For example, how many more young people will go to college because of the Gore tax breaks, and how much of the benefit of the tax cut would be a windfall to families of relatively affluent kids that would have gone anyway? The same criticism could be leveled at the Bush tax credits for health insurance.

Almost all distributional analyses are based on definitions that increase incomes 25% to 40% compared to the Adjusted Gross Income (AGI) we see each year on our tax forms, increasing the number of people in upper brackets and reducing the numbers in lower-income groups. Those definitions include the value of employer paid health and life insurance, tax-exempt interest, employer share of FICA, workers compensation, non-taxable Social Security benefits, insurance value of Medicare benefits, and in some instances the rental value of owner-occupied homes.

Table 1

The table below illustrates the impacts of the Bush-Cheney tax proposal in CY 2005.[1] We know of no bipartisan or nonpartisan estimates of distributional effects beyond 2005. But we are assured that the distributional effects for the provisions included in the analysis should hold thereafter.

Income Category ($)[2]	Change in Income Taxes[3]		Estimated Federal Taxes[3]				Effective Tax Rate[4]	
	$ Millions	%	Current Law		Bush-Cheney		Pre	Post
			$ billions	%	$ billions	%	%	%
< $10,000	-78	-1.0	8	.4	8	.4	9.8	9.7
10,000 to 20,000	-1,672	-6.2	27	1.4	26	1.4	7.4	7.0
20,000 to 30,000	-4,104	-6.1	67	3.4	63	3.4	12.2	11.4
30,000 to 40,000	-6,492	-6.2	105	5.3	99	5.3	15.9	14.9
40,000 to 50,000	-7,973	-6.7	119	6.0	111	6.0	17.3	16.2
50,000 to 75,000	-20,647	-6.4	320	16.2	300	16.2	19.7	18.4
75,000 to 100,000	-17,897	-6.1	294	14.8	276	14.8	22.1	20.8
100,000 to 200,000	-28,970	-5.8	497	25.1	468	25.1	25.0	23.6
200,000 and over	-32,245	-5.9	543	27.4	510	27.4	26.9	27.1
Total	120,079	-6.1	1,980	100	1,860	100	21.6	20.3

Source: Joint Committee on Taxation, May 2000

[1] Includes a phased-in increase in the child credit, reduction in individual marginal rates, the creation of a 10% bracket, a second earner deduction and a charitable deduction for non-itemizers. Does not include penalty-free IRA withdrawals for charitable contributions.

[2] The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus tax exempt interest, employer contributions for health plans and life insurance, employer share of FICA tax, workers' compensation, and excluded income of U.S. citizens living abroad. Categories are measured at 2000 levels.

[3] Includes individual income tax (including outlay portion of EITC), employment tax (attributed to employees) and excise taxes (attributed to consumers). Corporate income tax is not included due to uncertainty concerning the incidence of the tax.

4 Effective tax rate is equal to Federal Taxes described in footnote 3 divided by income described in footnote 2 plus additional income attributable to the proposal.

As noted above, arguments about the distribution of benefits under the Bush-Cheney plan center around the treatment of estate taxes. Let us stipulate that people who are well off would receive a substantial portion of the benefit from eliminating estate taxes. Having said that, it is just plain wrong to attribute 100% of the benefit to the top 1% of taxpayers.

Wealth and income are not identical concepts. Treating the value of an estate as income to the beneficiaries in the year they inherit is like comparing geese and ducks—they may look alike but they are not the same.

Dead people don't pay taxes. Heirs often have much lower incomes than their benefactors. If there is more than one heir, the per capita benefit obviously is less than the whole. If you think this is confusing, you should get into a discussion of the impact of estate taxes on family farms and small businesses. The reason there are no official estimates of the distribution of benefits from estate tax relief is that IRS does not collect the data needed to do that analysis.

With that out of the way, let us suggest a couple of guidelines and let you judge for yourself the "fairness" of various proposals.

♦ The rich pay a lot of taxes. The top 1% of taxpayers account for about 15% of income. They pay about one third of income taxes and abut 20% of total Federal taxes. The question is how much should they pay and should there be a limit? Governor Bush says that no one should a to rate higher than 33%. The Vice President has not said whether he thinks there should be a limit and if so what it should be. There is no objectively right level of taxation.

  One commentator suggests that the rich should forego a tax cut so the Federal government can pay for universal preschool. This raises two questions. Should universal preschool be a Federal responsibility? If so, should the very rich pay 100% of the cost? That is the kind of question you must answer for yourself.

♦ It probably makes better sense to look at impacts on taxpayers with incomes over $100,000 than to look at the top 1%. (There tends to be a lot of "noise" in the data about the very bottom and the very top categories of earners.) Individuals and families with incomes over $100,000 pay about 53% of all taxes and get about 50% of the benefits from the Bush tax plan. $100,000 per year is a good income but it is not rich. A policeman and a teacher married filing jointly, on the two coasts or in most big cities, earn over $100,000 per year. Those folks work hard and consider themselves middle class.

♦ To what extent should the tax code be used to redistribute income? Most economists and experts agree that the ideal tax system would have the broadest possible base and the lowest possible rates. That ideal is modified in many ways—to achieve progressivity, to encourage socially desirable uses of incomes such as home ownership, health insurance purchases, etc. Progressive systems require higher-income households to contribute a greater percentage of income (and more dollars) to support government. In recent years, that concept has been expanded to include "refundable tax cuts". Refundable credits are grants to individuals and households that do not pay enough taxes to reap the full benefits of these programs. How far should this concept stretch? By and large, we prefer to keep spending programs on the spending side of the budget. But that is a judgment call.

By contrast, the Gore-Liberman ticket needs the surplus to fund a very ambitious agenda designed to meet what they perceive to be pressing needs that they argue were neglected as a result of the cold war and record high deficits. We wrote earlier that the vice President's proposals would produce the largest spending increases since LBJ and the Great Society. That is true on the face of it. Of course, we also are enjoying the largest surpluses in modern history. But that is the nub of the controversy—what to do with those surpluses.

The table below illustrates the largely programatic in nature of the Gore-Lieberman tax cuts. It also may help readers determine who would benefit from what proposals.

Table 2

The format and all of the information about income limits in this table are taken from the Citizens for Tax Justice *Preliminary Analysis of the Gore Tax Plan*. Additional information is based on the Gore-Lieberman campaign document, *Prosperity for America's Future*. The impact of EITC on outlays and receipts is from the President's Budget for FY 2001.

Income limits for Gore tax Cuts				
Personal Items	**Singles**	**Couples**		
Earned Income Tax Credit (EITC)	35,600	37,000	Under current scorekeeping rules, 80% of the cost of EITC is reflected in outlays—payments to beneficiaries who do not owe enough income taxes otherwise to take full advantage of their entitlement. *	
Health Insurance Credits	Mostly low-income		Only for those without employer-paid insurance	
Dependent Care Credits	60,000	60,000	Not counting indexing, increases in age limit and infant, credit which are not capped	
Retirement Savings Plus (RSP)	15,000 30,000 50,000	30,000 50,000 100,000	3:1 match 1:1 match 1:3 match	Government would match individual deposits to qualified savings accounts. Withdrawals subject to special rules.
Married Standard Deduction	na	100,000	94% under 100K, 80% under $75 K	
Education Credits	60,000	120,000	Phase-out ends at these levels	
Long-Term-Care	75,000	110,000	Phase-out starts	
	135,000	170,000	Phase-out ends	
Tax Credits for Purchase of Energy Efficient Products	No income limit			
Estate Tax Cuts	No income limit		Applies only to family-owned businesses and farms	
Business Provisions				
Health Insurance Credits	Limited to businesses below a certain size			
Research and Experimentation (R&E) Credit	No limit (almost all goes to large corporations)			
Credits for Developing and Bringing to Market Energy Efficient Products	No Limit			

*Current rules count all spending associated with all refundable tax credits as outlays.

Without question, the Gore-Lieberman proposals are tailored to meet specific needs of families with incomes below $100,000. Indeed, most of the benefits would accrue to families with incomes below $75,000. The EITC expansion benefits all taxpayers that qualify by income and apply. Increasing the standard deduction for married couples to twice that of singles would benefit all that claim the standard deduction (non-itemizers). Taxpayers that qualify by income and purchase tax advantaged products and services, e.g., qualified health care coverage, day care, long term care, tuition for education and training, would benefit. Taxpayers that purchase energy efficient products would benefit regardless of income.

End of Session Madness

Congress was supposed to adjourn sine die October 6. They did not. Striking a deal on appropriations for FY 2001 may prove to be more difficult than anyone imagined earlier this year. With the advent of surpluses we are proving Parkinson's law over and over again—demand truly does expand to meet available resources.

As surpluses have grown, so has discretionary spending. In fact, discretionary spending increases over the last three years were the largest since the end of the Viet Nam War. That pattern undoubtedly will continue—and the increase in discretionary spending will once again exceed the total budgets of all but a handful of States. The baseline that both presidential candidates have adopted includes $1 trillion over ten years for inflation adjustments to discretionary spending. Governor Bush proposes to increase spending almost half that much again. The Vice President's proposed spending increases are nearly three times the Governor's.

In this environment, almost every Member of Congress has some special project they want funded in their District or State—and can you really blame them? The President insists on funding for his priorities. Add congressional priorities and almost any compromise almost certainly will add up to more than the President's Budget, the Congressional Budget, and our earlier estimates.

The pressure for adjournment is building rapidly. Members want to go home and campaign. We devoutly hope for a compromise in the next few days—however costly that might be. The alternative is a lame duck session—and that truly would be a nightmare.

Bush/Cheney Tax Cut Proposal-- Fiscal Years 2001-2010--$ in billions

Double Child Credit and Apply to AMT; increase start-point for phase-out and reduce phase-out rate	162.3
Create New 10% Bottom Bracket	288.4
Reduce Tax Rates	439
Marriage Penalty Relief	87.7
Charitable Deductions for Non-Itemizers	75.8
Tax Free and Penalty Free IRA Withdrawals Over 55 for Charitable Contributions	2.1
Raise Cap On Corporate Charitable Contributions	1.7
Permanent R&E Credit	23.8
Estate Tax Phase-Out	236.2
Total	1317

Additional "targeted tax provisions", included in the Bush-Cheney proposal, classified as education, health care, etc. These amounts are reflected as spending in our analysis of the Bush-Cheney program.

Expand Education IRAs	3.5
Health Tax Credit*	63
FSA Rollover	6.6
MSAs	4.1
Long-Term Care-Deduction	11.6
Caregiver Exemption	2.4
Teacher Out-of-pocket Deduction	1.4
Charity State Tax Credit**	11
Expand Adoption Tax Credit, Make permanent & Refundable	3.6
FFARM Accounts	0.9
IDA Tax Credit	1.8
50% Cap Gains Tax Credit (Environment)	0.8
Telecommuting Equipment-- Make a Tax Free Benefit	0.7
	107.9

* The health care credit is refundable and would primarily increase outlays. We already show these amounts as program expenditures in our comparison of the campaigns' economic policies.

** The Charity State Tax Credit is not a federal tax provision. It is intended to encourage States to use tax credits for charitable purposes. TANF (welfare) funds could be used to offset the cost to State treasuries. At the federal level the proposal would increase outlays—it would not affect revenues.

Gore-Lieberman--Targeted Tax Cuts*
2001-2010 ($ in billions--totals may not add due to rounding

Better America Bonds	3
Brownfields Permanently Extend Credit	1
Child/Dependent Care/After School Credit	36
College Opportunity Deduction/Credit	36
Conservation Incentives	2
Democracy Endowment	2
Digital Divide	2
Disability Credit	2
401(j) Education & Training Accounts	3
EITC	29
Energy Efficiency	45
Estate Tax Relief--Family Owned Farms & Businesses	11
Expand Empowerment Zones/Communities Incentives	4
Health Insurance Credit	48
Low Income Housing Credit	6
Long Term Care	27
Marriage Penalty Relief for Non-Itemizers Only	66
National Tuition Savings	2
New markets	5
Portability of Pensions--simplify, including 415	1
R&E Tax Credit Permanent	24
Retirement Savings withdrawals	3
RSP	200
School construction Tax Credit	8
Small Business Health Insurance Credit	*
Small Business Pension Start-UP	1
Technology Bonds	1
Training Tax Credits	1
Unallocated Tax Cuts	9
	575

* This table reflects the gross amounts of provision that appear in Gore-Lieberman campaign materials as tax cuts. Our analysis does not count $95 billion in "loophole closers". We do count $120 billion of these amounts as outlays. As noted in the correction on page one of this document, an adjustment for the Gore campaign's scoring of their Retirement Security Plus proposal would increase the size of the tax cut and reduce total outlays compared to our analysis. However, we believe the entire cost of that program ought to be counted as entitlement spending.