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"Contract with America" Analysis [binder]

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# **"Contract with America" Analysis**

**PHOTOCOPY  
PRESERVATION**

"Contract  
with  
America"  
Analysis

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DEPARTMENT OF THE TREASURY

TREASURY



NEWS

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FOR IMMEDIATE RELEASE  
March 14, 1995

### TOP EARNERS GET BULK OF GOP TAX PLAN BENEFITS, STUDY SAYS

The wealthiest 12 percent of Americans would receive more than half of the tax cuts proposed in the House Ways and Means Committee, according to Treasury Department estimates released Tuesday.

The estimates also show the cuts would cost \$630 billion over the next 10 years.

"Tax cuts need to satisfy three criteria -- promoting economic growth, tax fairness and a full funding with no budget gimmicks," Treasury Secretary Robert Rubin said.

"Whatever we do, it must be paid for. You don't balance budgets by cutting taxes and not cutting spending," Rubin said.

According to the Treasury estimates, the Republican proposal would give more than half (51.5 percent) of the tax benefits to the 13.4 million families earning \$100,000 or more a year. That's only the top 12 percent of American families. And some 20 percent of the tax benefits go to just 1 percent, or 1.1 million, of American families earning nearly \$350,000 or more a year.

Meanwhile, Americans earning between \$30,000 and \$100,000 -- 51.8 million families -- would receive only 43.2 percent of the tax relief, the estimates show.

President Clinton is proposing a 10-year, \$172 billion tax cut for working middle class Americans. The Middle Class Bill of Rights included in the President's fiscal 1996 budget calls for a \$500 tax credit for dependent children under age 13, a deduction of up to \$10,000 for education expenses, and expanded individual retirement accounts (IRAs).

The GOP package, pending before the House tax-writing panel, includes several costly tax breaks for corporations and upper income individuals. For example, scaling

(more)

RR-151

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Primary Revenue Estimates  
Middle-Class Tax Cut

	13-Mar-95	Fiscal Years										1995-2000	1995-2005	
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004			2005
(\$'s in billions)														
<b>Child Tax Benefit</b>														
Credit for children 12-years and under; credit = \$300 for 1996, 1997, and 1998, \$500 for 1999 and thereafter; phase-out AGI between \$60,000 - \$75,000; effective 1/1/96		0.0	-3.5	-6.8	-6.6	-8.3	-10.1	-10.1	-9.9	-9.7	-9.4	-9.8	-35.4	-84.2
<b>Education and Job Training Incentive</b>														
Phased-in deduction for up-to \$10,000 in post-secondary education and training expenses with phase-out AGI between \$70,000 - \$90,000 single, \$100,000 - \$120,000 joint; phase-in= \$5,000 for 1996, 1997, and 1998, \$10,000 for 1999 and thereafter		0.0	-0.7	-4.7	-5.0	-5.8	-7.6	-7.6	-7.9	-8.1	-8.3	-8.5	-23.7	-64.1
<b>Savings Incentive</b>														
Expand eligibility for deductible "front-loaded" IRAs by increasing AGI eligibility phase-out from current \$40,000 - \$50,000 to \$80,000 - \$100,000 for joint returns (current \$25,000 - \$35,000 phase-out increased to \$50,000 - \$70,000 for single returns); add new "back-loaded IRA option; allow conversion of existing IRAs into "back-loaded" IRAs and retain current law non-working spouse limit; allow penalty-free withdrawals for education, first home, medical expenses, long-term unemployment and care for elderly		0.0	0.4	-0.3	-0.8	-1.0	-2.0	-3.3	-3.6	-3.9	-4.2	-4.5	-3.8	-23.3
<b>Middle-class tax cut total</b>		<b>0.0</b>	<b>-3.8</b>	<b>-11.8</b>	<b>-12.4</b>	<b>-15.1</b>	<b>-19.7</b>	<b>-21.0</b>	<b>-21.4</b>	<b>-21.7</b>	<b>-21.9</b>	<b>-22.8</b>	<b>-62.8</b>	<b>-171.7</b>

Department of the Treasury  
Office of Tax Analysis

## ESTIMATED EFFECTS ON RECEIPTS 1/

"CONTRACT WITH AMERICA TAX RELIEF ACT OF 1995"  
WAYS AND MEANS CHAIRMAN'S MARK

Provision 2/	13-Mar-95	Fiscal Years										1995-2000	1995-2005	
		1995	1996	1997	1998	1999	2000	2001	2002	2003	2004			2005
		(\$'s in billions)												
✓ 1 \$500 per child credit		-	-11.7	-23.5	-24.5	-25.4	-25.2	-25.8	-26.0	-25.1	-24.7	-23.9	-110.3	-235.8
✓ 2 American Dream Savings Accounts		-	0.3	1.1	1.6	0.9	-0.1	-2.2	-4.1	-5.3	-6.5	-7.5	3.8	-21.8
✓ 3 Favorable tax treatment of long-term care insurance and services		-	-0.5	-1.1	-1.2	-1.4	-1.6	-1.8	-2.1	-2.3	-2.8	-2.9	-5.9	-17.6
4 Tax-free accelerated death benefits under life insurance contracts		-	-0.0	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.8
5 Increased expensing limit for small business		-	-0.5	-1.4	-2.0	-2.3	-1.8	-1.3	-1.1	-0.8	-0.7	-0.7	-8.0	-12.5
✓ 6 \$5,000 tax credit for adoption expenses		-	-0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9	-2.0
✓ 7 \$500 tax credit for elderly care		-	-0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.9	-2.1
8 Neutral Cost Recovery 3/		3.3	10.0	13.4	8.5	-2.8	-14.1	-21.5	-26.0	-28.7	-30.4	-32.2	18.4	-120.4
9 Corporate and Individual Alternative Minimum Tax (AMT) relief 4/		-1.3	-3.3	-4.0	-3.6	-3.4	-3.1	-4.2	-4.2	-3.3	-2.8	-2.5	-18.7	-35.6
10 Interaction between Neutral Cost Recovery and AMT provisions		0.4	1.1	1.3	1.0	0.6	0.1	-0.2	-0.3	-0.3	-0.3	-0.2	4.5	3.1
11 Leasehold Improvements provision		-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.0	-0.2	-0.4
✓ 12 Capital gains tax preferences		0.7	1.4	-3.8	-7.8	-8.0	-10.0	-11.0	-11.9	-12.7	-13.5	-14.4	-28.4	-91.9
✓ 13 Phase-out of the 85 percent maximum inclusion rate for social security benefits		-	-0.5	-1.9	-3.2	-4.3	-5.3	-6.0	-6.4	-6.8	-7.1	-7.5	-15.3	-49.1
✓ 14 Tax credit to reduce marriage penalties		-	-0.4	-2.0	-2.0	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-2.1	-8.8	-19.0
15 Expansion of the home office deduction		-	-0.0	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.7	-1.8
16 Increase unified estate and gift tax exclusions and exemptions		-	0.0	-1.4	-1.6	-1.8	-2.0	-2.4	-2.7	-3.0	-3.6	-4.1	-8.7	-22.6
<b>Total effect on receipts</b>		<b>3.1</b>	<b>-4.4</b>	<b>-24.0</b>	<b>-35.6</b>	<b>-51.3</b>	<b>-65.9</b>	<b>-79.2</b>	<b>-87.7</b>	<b>-91.2</b>	<b>-95.1</b>	<b>-98.9</b>	<b>-178.1</b>	<b>-630.2</b>

Department of the Treasury  
Office of Tax Analysis

1/ Does not include outlay effects of modifications to social security earnings limitations.

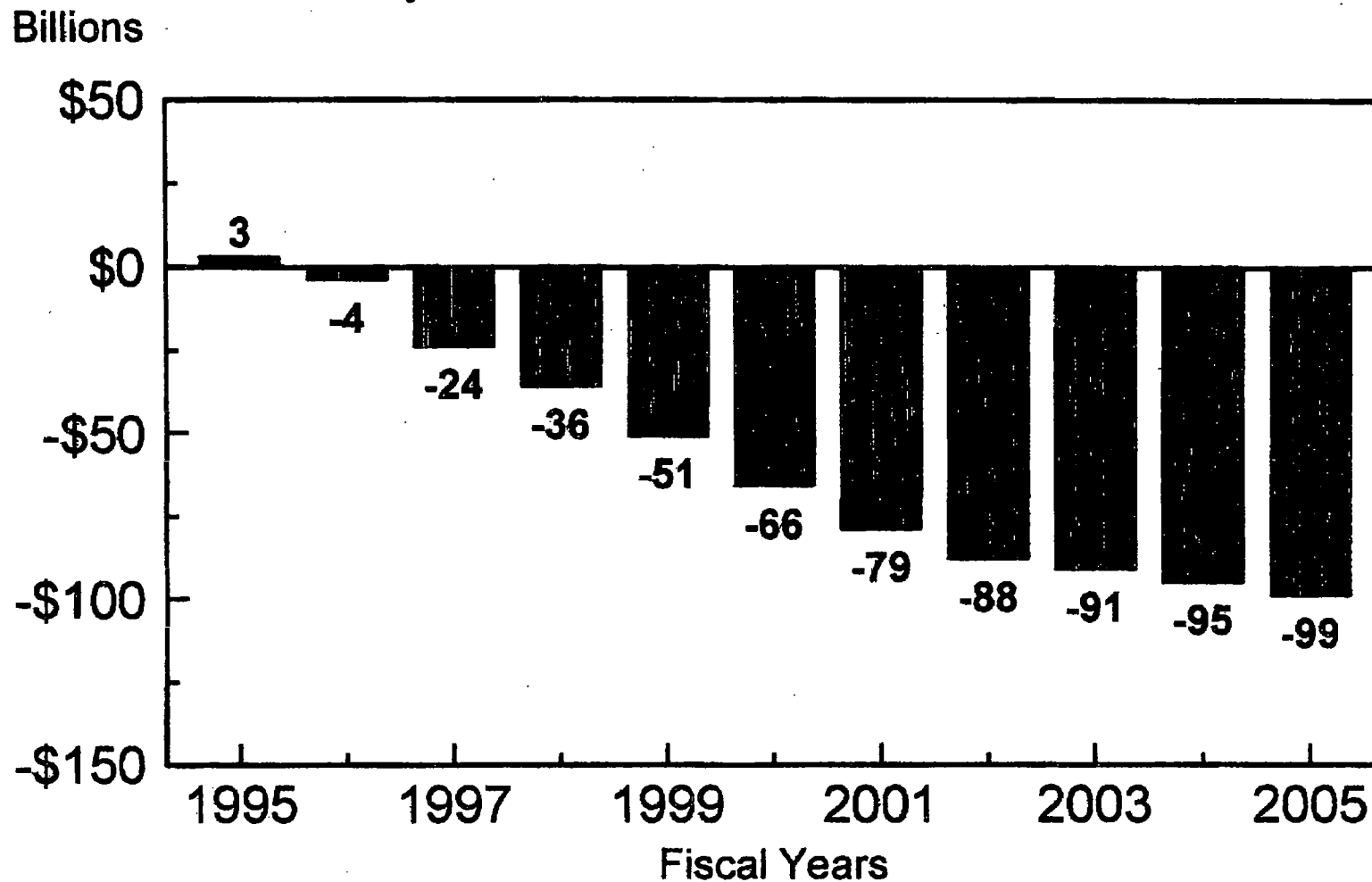
2/ Provisions are effective 1/1/96 unless otherwise noted. Estimates are based upon March 9, 1995 JCT provision descriptions (JCX-9-95).

3/ Effective for property placed in service after 12/31/84.

4/ Generally effective 1/1/86. The AMT depreciation adjustment would be repealed for 1) all property covered under NCRS and 2) all other depreciable property placed in service after 3/13/95.

# Revenue Effect of Contract With America

## Ways and Means Chairman's Mark



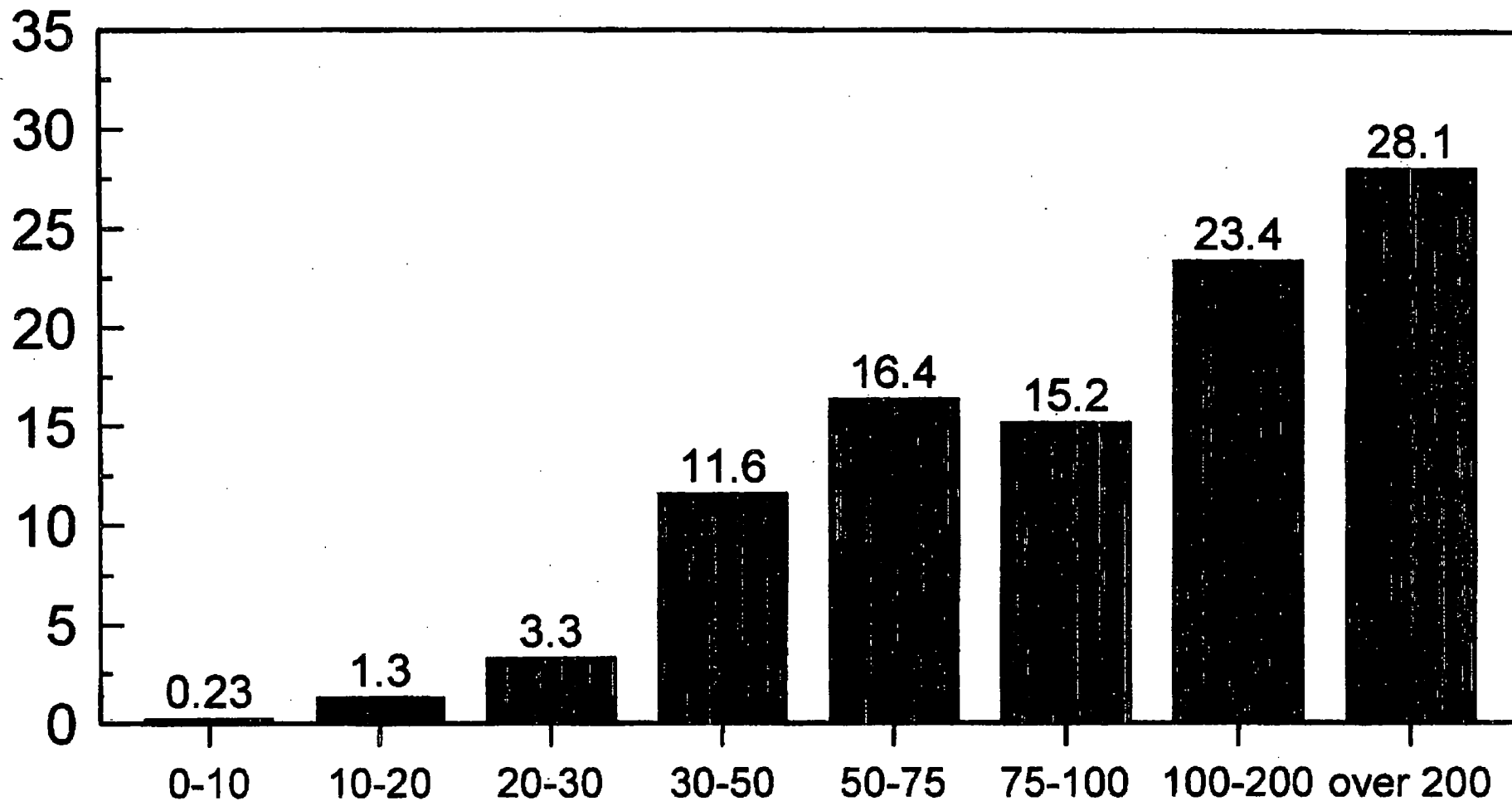
5 year cost: \$178 billion  
10 year cost: \$630 billion

Source: Department of the Treasury, Office of Tax Analysis

# Top 12 Percent Get More Than Half of the Tax Benefits

Ways and Means Chairman's Mark

Percent



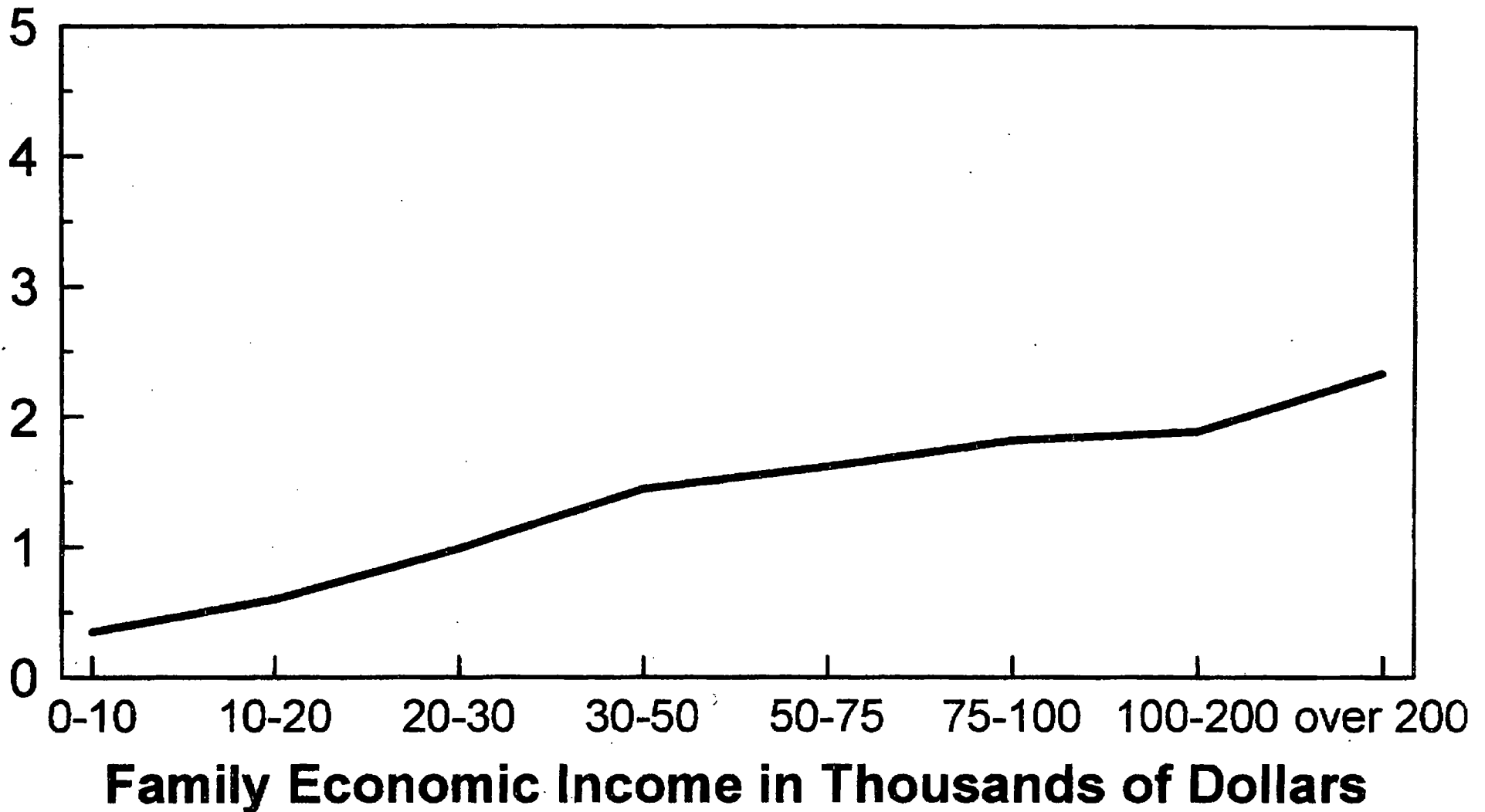
**Family Economic Income in Thousands of Dollars**

Source: Department of the Treasury, Office of Tax Analysis

# Tax Benefits As A Share of Income

## Ways and Means Chairman's Mark

Percent

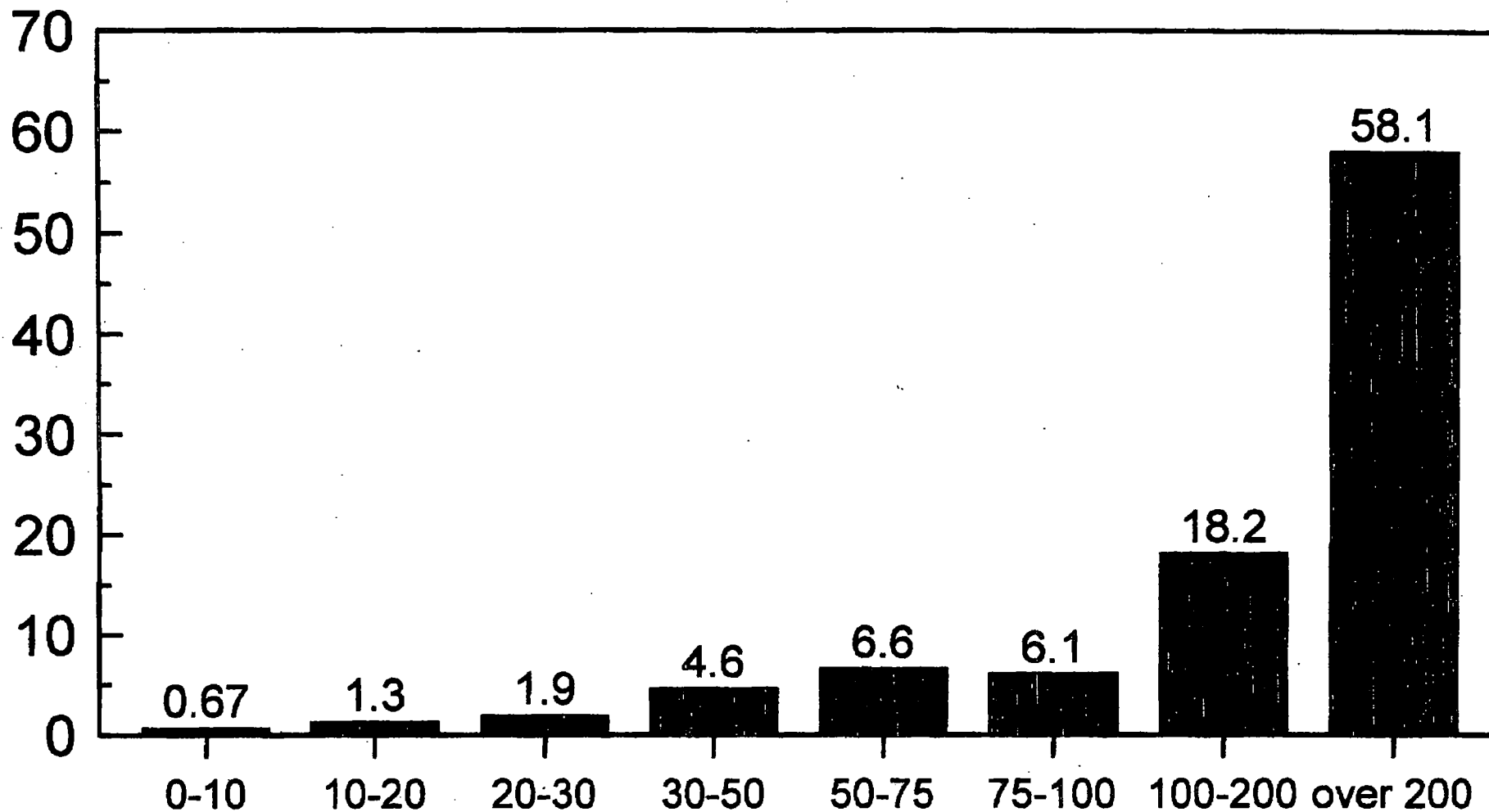


Source: Department of the Treasury, Office of Tax Analysis

# Top 12 Percent Get Three-Fourths of the Capital Gains Benefits

Ways and Means Chairman's Mark

Percent



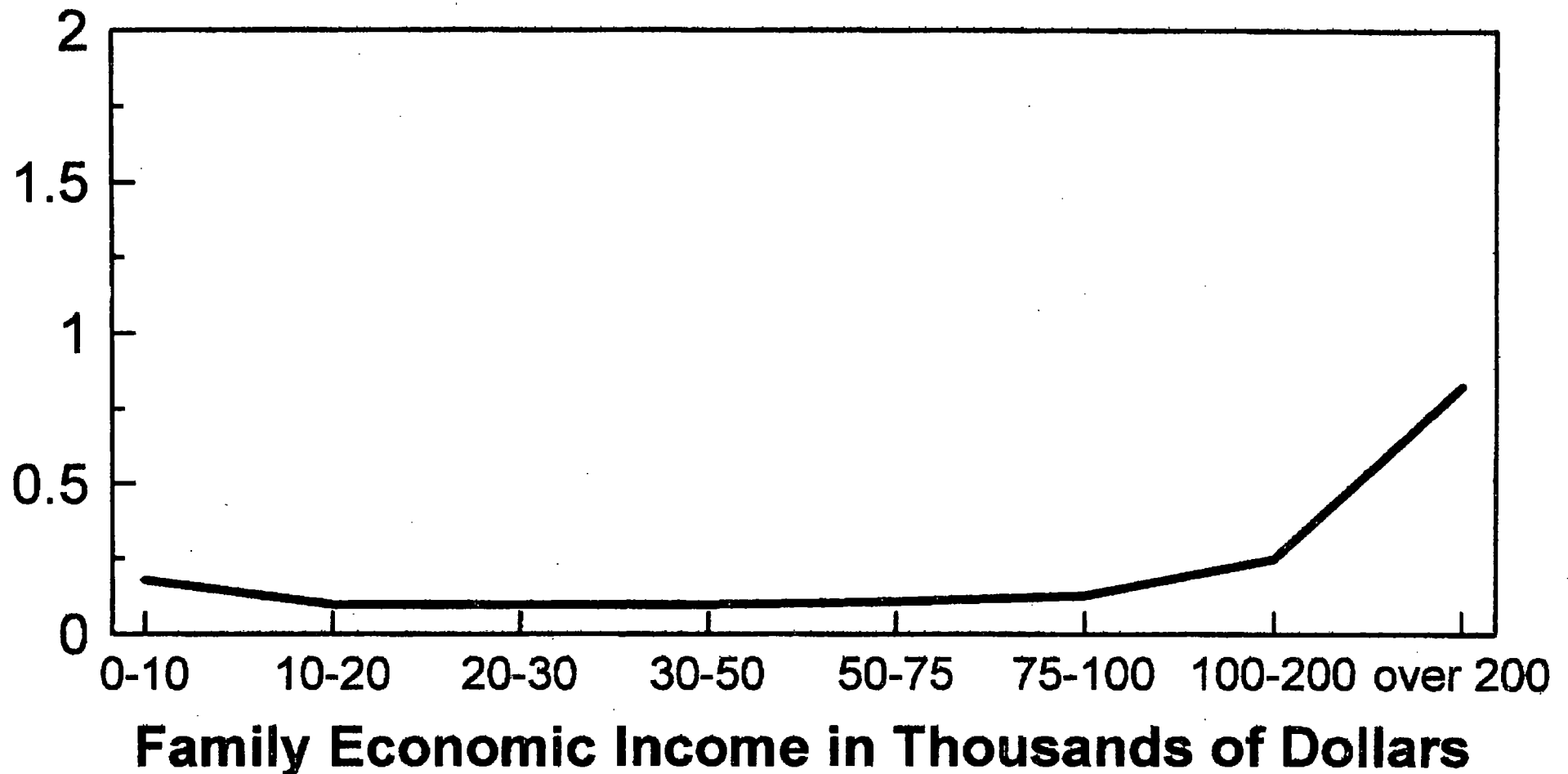
**Family Economic Income in Thousands of Dollars**

Source: Department of the Treasury, Office of Tax Analysis

# Tax Benefits As A Share of Income Capital Gains Cut

Ways and Means Chairman's Mark

Percent



Source: Department of the Treasury, Office of Tax Analysis

## President's Middle-Class Tax Cut Proposal (1)

(1996 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change (\$)	Total Tax Change		Tax Change as a Percent	
			Amount (3) (\$M)	Percent Distribution (%)	of Income (%)	of Current Federal Taxes (%)
0 - 10	12.5	-5	-63	0.3	-0.09	-1.11
10 - 20	16.2	-29	-461	1.9	-0.19	-2.15
20 - 30	15.1	-69	-1040	4.2	-0.28	-2.08
30 - 50	22.7	-251	-5700	22.9	-0.64	-3.65
50 - 75	18.3	-422	-7746	31.1	-0.69	-3.46
75 - 100	10.8	-558	-6025	24.2	-0.65	-3.07
100 - 200	10.6	-342	-3616	14.5	-0.26	-1.19
200 & over	2.8	-82	-227	0.9	-0.02	-0.07
Total (4)	109.4	-227	-24881	100.0	-0.39	-1.95

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the President's middle-class tax cut proposal. The proposal includes a \$500 nonrefundable credit for children aged 12 and under which phases out between AGIs of \$60,000 and \$75,000 on all returns, regardless of filing status. The credit would be taken after the EITC. The credit and the phaseout range would be indexed for inflation after 2000. The proposal also includes an above the line deduction for post-secondary education and training expenses of up to \$10,000. The deduction phases out between AGIs of \$70,000 and \$90,000 on single returns and \$100,000 and \$120,000 on joint returns. Finally, the proposal includes an increase in the phaseout range for deductible IRA contributions to AGIs between \$50,000 and \$70,000 for single returns and \$80,000 and \$100,000 on joint returns, allows taxpayers below these income limits the option of making nondeductible contributions to a "back-loaded" IRA, and provides penalty-free withdrawals for specified purposes.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income, IRA and Keogh deductions, nontaxable transfer payments such as Social Security and AFDC, employer-provided fringe benefits, inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest, and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in (2000) law and behavior. For the IRA proposal, the change is measured as the present value of the tax savings from one-year's contributions.
- (4) Families with negative incomes are included in the total line but not shown separately.

## President's Middle-Class Tax Cut Proposal (1)

(1996 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change (\$)	Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
			Amount (3) (\$M)	Percent Distribution (%)		
Lowest (4)	21.4	-12	-267	1.1	-0.14	-1.88
Second	21.9	-57	-1248	5.0	-0.25	-2.04
Third	21.9	-242	-5286	21.2	-0.63	-3.61
Fourth	21.9	-430	-9402	37.8	-0.69	-3.46
Highest	21.9	-396	-8675	34.9	-0.25	-1.11
Total (4)	109.4	-227	-24881	100.0	-0.39	-1.95
Top 10%	10.9	-243	-2664	10.7	-0.11	-0.47
Top 5%	5.5	-126	-688	2.8	-0.04	-0.17
Top 1%	1.1	-63	-69	0.3	-0.01	-0.03

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the President's middle-class tax cut proposal. The proposal includes a \$500 nonrefundable credit for children aged 12 and under which phases out between AGIs of \$60,000 and \$75,000 on all returns, regardless of filing status. The credit would be taken after the EITC. The credit and the phaseout range would be indexed for inflation after 2000. The proposal also includes an above the line deduction for post-secondary education and training expenses of up to \$10,000. The deduction phases out between AGIs of \$70,000 and \$90,000 on single returns and \$100,000 and \$120,000 on joint returns. Finally, the proposal includes an increase in the phaseout range for deductible IRA contributions to AGIs between \$50,000 and \$70,000 for single returns and \$80,000 and \$100,000 on joint returns, allows taxpayers below these income limits the option of making nondeductible contributions to a "back-loaded" IRA, and provides penalty-free withdrawals for specified purposes.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income, IRA and Keogh deductions, nontaxable transfer payments such as Social Security and AFDC, employer-provided fringe benefits, inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest, and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in (2000) law and behavior. For the IRA proposal, the change is measured as the present value of the tax savings from one-year's contributions.
- (4) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604, Third \$29,717, Fourth \$48,660, Highest \$79,056, Top 10% \$108,704, Top 5% \$145,412, Top 1% \$349,438.

**Percentage Distribution of Tax Cuts:  
Republican "Contract with America" and the  
President's Middle-Class Tax Cut Proposal**

(1996 Income Levels)

Family Economic Income Class (1) (000)	Number of Families (millions)	Percentage Distribution of Tax Cuts:	
		Republican "Contract with America" (%)	President's Middle-Class Tax Cut (%)
0 - 10	12.5	0.4	0.3
10 - 20	16.2	1.6	1.9
20 - 30	15.1	4.1	4.2
30 - 50	22.7	12.4	22.9
50 - 75	18.3	16.2	31.1
75 - 100	10.8	14.8	24.2
100 - 200	10.6	22.8	14.5
200 & over	2.8	27.4	0.9
<b>Total (2)</b>	<b>109.4</b>	<b>100.0</b>	<b>100.0</b>

Department of the Treasury  
Office of Tax Analysis

March 9, 1995

(1) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income, IRA and Keogh deductions, nontaxable transfer payments such as Social Security and AFDC, employer-provided fringe benefits, inside build-up on pensions, IRAs, Keoghs, and life insurance, tax-exempt interest, and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(2) Families with negative incomes are included in the total line but not shown separately.

**Percentage Distribution of Tax Cuts:  
Republican "Contract with America" and the  
President's Middle-Class Tax Cut Proposal**

(1996 Income Levels)

Family Economic Income Quintile (1)	Number of Families (millions)	Percentage Distribution of Tax Cuts:	
		Republican "Contract with America" (%)	President's Middle-Class Tax Cut (%)
Lowest (2)	21.4	0.9	1.1
Second	21.9	4.9	5.0
Third	21.9	11.7	21.2
Fourth	21.9	19.7	37.8
Highest	21.9	62.2	34.9
Total (2)	109.4	100.0	100.0
Top 10%	10.9	46.1	10.7
Top 5%	5.5	35.3	2.8
Top 1%	1.1	19.5	0.3

Department of the Treasury  
Office of Tax Analysis

March 9, 1995

(1) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income, IRA and Keogh deductions, nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits, inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest, and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.

(2) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604, Third \$29,717, Fourth \$48,660, Highest \$79,056, Top 10% \$108,704; Top 5% \$145,412, Top 1% \$349,438.

**Tax Proposals in "Contract with America Tax Relief Act of 1995" (1)**  
**(Ways and Means Chairman's Mark)**  
 (1996 Income Levels)

Family Economic Income Class (2) (000)	Number of Families (millions)	Average Tax Change (\$)	Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
			Amount (3) (\$M)	Percent Distribution (%)		
0 - 10	12.5	-20	-251	0.23	-0.35	-4.43
10 - 20	16.2	-90	-1462	1.3	-0.60	-6.81
20 - 30	15.1	-247	-3718	3.3	-0.99	-7.42
30 - 50	22.7	-569	-12934	11.6	-1.45	-8.28
50 - 75	18.3	-997	-18293	16.4	-1.62	-8.17
75 - 100	10.8	-1572	-16976	15.2	-1.82	-8.66
100 - 200	10.6	-2465	-26049	23.4	-1.89	-8.60
200 & over	2.8	-11266	-31319	28.1	-2.34	-9.89
<b>Total (4)</b>	<b>109.4</b>	<b>-1019</b>	<b>-111517</b>	<b>100.0</b>	<b>-1.76</b>	<b>-8.75</b>

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America Tax Relief Act of 1995," as released by the Ways and Means Chairman March 11, 1995.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded ADSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes.
- (4) Families with negative incomes are included in the total line but not shown separately.

**Tax Proposals in "Contract with America Tax Relief Act of 1995" (1)**  
**(Ways and Means Chairman's Mark)**  
 (1996 Income Levels)

Family Economic Income Quintile (2)	Number of Families (millions)	Average Tax Change (\$)	Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
			Amount (3) (\$M)	Percent Distribution (%)		
Lowest (4)	21.4	-36	-781	0.7	-0.42	-5.51
Second	21.9	-205	-4492	4.0	-0.91	-7.33
Third	21.9	-555	-12149	10.9	-1.44	-8.29
Fourth	21.9	-1021	-22353	20.0	-1.64	-8.22
Highest	21.9	-3255	-71228	63.9	-2.05	-9.14
Total (4)	109.4	-1019	-111517	100.0	-1.76	-8.75
Top 10%	10.9	-4821	-52755	47.3	-2.14	-9.33
Top 5%	5.5	-7369	-40316	36.2	-2.26	-9.71
Top 1%	1.1	-20362	-22276	20.0	-2.46	-10.04

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America Tax Relief Act of 1995," as released by the Ways and Means Chairman March 11, 1995.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded ADSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes.
- (4) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604; Third \$29,717; Fourth \$48,660; Highest \$79,056;  
Top 10% \$108,704; Top 5% \$145,412; Top 1% \$349,438.

**Tax Proposals in "Contract with America Tax Relief Act of 1995" (1)**  
**(Ways and Means Chairman's Mark)**  
 (1996 Income Levels)

Family Economic Income Class (4) (000)	Federal Taxes Under Current Law (2)			Change in Federal Taxes (3)			Total Federal Taxes After Change		
	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)
0 - 10	5.7	8.0	8.7	-0.3	(0.4)	(0.4)	5.4	7.7	8.3
10 - 20	21.5	8.8	9.7	-1.5	(0.6)	(0.7)	20.0	8.2	9.0
20 - 30	50.1	13.3	15.4	-3.7	(1.0)	(1.1)	46.4	12.3	14.2
30 - 50	156.3	17.5	21.2	-12.9	(1.4)	(1.8)	143.4	16.0	19.4
50 - 75	224.0	19.9	24.8	-18.3	(1.6)	(2.0)	205.7	18.3	22.8
75 - 100	196.1	21.1	26.7	-17.0	(1.8)	(2.3)	179.1	19.2	24.4
100 - 200	303.0	22.0	28.1	-26.0	(1.9)	(2.4)	277.0	20.1	25.7
200 & over	316.6	23.7	31.1	-31.3	(2.3)	(3.1)	285.3	21.4	28.0
<b>Total (5)</b>	<b>1,275.1</b>	<b>20.1</b>	<b>25.2</b>	<b>-111.5</b>	<b>(1.8)</b>	<b>(2.2)</b>	<b>1,163.6</b>	<b>18.4</b>	<b>23.0</b>

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America Tax Relief Act of 1995," as released by the Ways and Means Chairman March 11, 1995.
- (2) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period are excluded.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded ADSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion and prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes (see footnote 2).
- (4) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (5) Families with negative incomes are included in the total line but not shown separately.

**Tax Proposals in "Contract with America Tax Relief Act of 1995" (1)**  
**(Ways and Means Chairman's Mark)**  
 (1996 Income Levels)

Family Economic Income Quintile (4)	Federal Taxes Under Current Law (2)			Change in Federal Taxes (3)			Total Federal Taxes After Change		
	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)	Amount (\$B)	As a Percent of Pre-Tax Income (%)	As a Percent of After-Tax Income (%)
Lowest (5)	14.2	7.6	8.3	-0.8	(0.4)	(0.5)	13.4	7.2	7.8
Second	61.2	12.4	14.2	-4.5	(0.9)	(1.0)	56.7	11.5	13.2
Third	146.5	17.3	21.0	-12.1	(1.4)	(1.7)	134.3	15.9	19.2
Fourth	271.8	19.9	24.9	-22.4	(1.6)	(2.0)	249.4	18.3	22.8
Highest	779.5	22.4	28.9	-71.2	(2.1)	(2.6)	708.3	20.4	26.3
Total (5)	1,275.1	20.1	25.2	-111.5	(1.8)	(2.2)	1,163.6	18.4	23.0
Top 10%	565.3	22.9	29.8	-52.8	(2.1)	(2.8)	512.5	20.8	27.0
Top 5%	415.3	23.2	30.3	-40.3	(2.3)	(2.9)	375.0	21.0	27.3
Top 1%	221.9	24.5	32.5	-22.3	(2.5)	(3.3)	199.7	22.1	29.2

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the tax provisions in the "Contract with America Tax Relief Act of 1995," as released by the Ways and Means Chairman March 11, 1995.
- (2) The taxes included are individual and corporate income, payroll (Social Security and unemployment), and excises. Estate and gift taxes and customs duties are excluded. The individual income tax is assumed to be borne by payors, the corporate income tax by capital income generally, payroll taxes (employer and employee shares) by labor (wages and self-employment income), excises on purchases by individuals by the purchaser, and excises on purchases by business in proportion to total consumption expenditures. Taxes due to provisions that expire prior to the end of the Budget period are excluded.
- (3) The change in Federal taxes is estimated at 1996 income levels but assuming fully phased in law and long-run behavior. The effect of the back-loaded AOSA proposal is measured as the present value of tax savings on one year's contributions. The effect of the neutral cost recovery proposal is measured as the present value of the tax savings from one year's investment. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the proposed capital gains exclusion and prospective indexing are based on the level of capital gains realizations under current law. The incidence assumptions for tax changes is the same as for current law taxes (see footnote 2).
- (4) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments, such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family, rather than on a tax return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (5) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604; Third \$29,717; Fourth \$48,660; Highest \$79,056; Top 10% \$108,704; Top 5% \$145,412; Top 1% \$349,438.

**50% Exclusion and Indexing of Capital Gains for Individuals  
in the "Contract with America Tax Relief Act of 1995" (1)  
(Ways and Means Chairman's Mark)  
(1996 Income Levels)**

Family Economic Income Class (2) (000)	Families with Tax Change			Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
	Number (millions)	Percent of All Families (%)	Average Tax Change (\$)	Amount (\$M)	Percent Distribution (%)		
0 - 10	0.1	0.8	-1347	-128	0.67	-0.18	-2.25
10 - 20	0.3	2.0	-778	-246	1.3	-0.10	-1.15
20 - 30	0.5	3.4	-694	-360	1.9	-0.10	-0.72
30 - 50	1.4	6.0	-657	-889	4.6	-0.10	-0.57
50 - 75	1.6	9.0	-772	-1270	6.6	-0.11	-0.57
75 - 100	1.4	12.5	-868	-1173	6.1	-0.13	-0.60
100 - 200	2.4	22.7	-1448	-3480	18.2	-0.25	-1.15
200 & over	1.4	51.6	-7766	-11137	58.1	-0.83	-3.52
Total (3)	9.1	8.4	-2097	-19164	100.0	-0.30	-1.50

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the proposed 50% exclusion and indexing of capital gains for individuals. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the exclusion and indexing are based on the level of capital gains realizations under current law.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) Families with negative incomes are included in the total line but not shown separately.

**50% Exclusion and Indexing of Capital Gains for Individuals  
in the "Contract with America Tax Relief Act of 1995" (1)  
(Ways and Means Chairman's Mark)  
(1996 Income Levels)**

Family Economic Income Quintile (2)	Families with Tax Change			Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
	Number (millions)	Percent of All Families (%)	Average Tax Change (\$)	Amount (\$M)	Percent Distribution (%)		
Lowest (3)	0.2	1.1	-992	-240	1.3	-0.13	-1.69
Second	0.7	3.1	-701	-472	2.5	-0.10	-0.77
Third	1.3	5.9	-686	-882	4.6	-0.10	-0.60
Fourth	2.0	9.0	-761	-1500	7.8	-0.11	-0.55
Highest	4.9	22.6	-3152	-15589	81.3	-0.45	-2.00
Total (3)	9.1	8.4	-2097	-19164	100.0	-0.30	-1.50
Top 10%	3.5	31.6	-4100	-14159	73.9	-0.57	-2.50
Top 5%	2.3	42.3	-5508	-12746	66.5	-0.71	-3.07
Top 1%	0.7	62.2	-12931	-8793	45.9	-0.97	-3.96

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in tax burdens due to the proposed 50% exclusion and indexing of capital gains for individuals. The effect of the prospective capital gains indexing proposal is the fully phased in tax savings, multiplied by the ratio of the sum of the present values of prospective indexing over 17 years to the sum of the present values of fully phased in indexing over 17 years, holding realizations constant. The effect on tax burdens of the exclusion and indexing are based on the level of capital gains realizations under current law.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604; Third \$29,717; Fourth \$48,660; Highest \$79,056;  
Top 10% \$108,704; Top 5% \$145,412; Top 1% \$349,438.

**\$500 Nonrefundable Credit for Children 17 and Under  
in the "Contract with America Tax Relief Act of 1995" (1)  
(Ways and Means Chairman's Mark)  
(1996 Income Levels)**

Family Economic Income Class (2) (000)	Families with Tax Change			Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
	Number (millions)	Percent of All Families (%)	Average Tax Change (\$)	Amount (\$M)	Percent Distribution (%)		
0 - 10	0.02	0.1	-400	-6	0.03	-0.008	-0.11
10 - 20	1.3	8.3	-330	-442	1.9	-0.18	-2.06
20 - 30	3.4	22.9	-493	-1700	7.2	-0.45	-3.39
30 - 50	7.2	31.6	-735	-5291	22.6	-0.59	-3.39
50 - 75	7.9	42.8	-846	-6646	28.3	-0.59	-2.97
75 - 100	5.5	51.0	-871	-4796	20.4	-0.52	-2.45
100 - 200	4.8	45.6	-856	-4123	17.6	-0.30	-1.36
200 & over	0.6	22.9	-704	-449	1.9	-0.03	-0.14
Total (3)	30.8	28.2	-761	-23456	100.0	-0.37	-1.84

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in taxes due to the proposed \$500 nonrefundable credit for children aged 17 and under which phases out between AGIs of \$200,000 and \$250,000 on all returns, regardless of filing status. The credit would be taken before the EITC. The credit amount and phaseout range would be indexed for inflation.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) Families with negative incomes are included in the total line but not shown separately.

**\$500 Nonrefundable Credit for Children 17 and Under  
in the "Contract with America Tax Relief Act of 1995" (1)  
(Ways and Means Chairman's Mark)  
(1996 Income Levels)**

Family Economic Income Quintile (2)	Families with Tax Change			Total Tax Change		Tax Change as a Percent of Income (%)	Tax Change as a Percent of Current Federal Taxes (%)
	Number (millions)	Percent of All Families (%)	Average Tax Change (\$)	Amount (\$M)	Percent Distribution (%)		
Lowest (3)	0.4	1.8	-236	-93	0.4	-0.05	-0.66
Second	4.3	19.6	-462	-1980	8.4	-0.40	-3.23
Third	6.9	31.3	-724	-4966	21.2	-0.59	-3.39
Fourth	9.4	43.2	-848	-8008	34.1	-0.59	-2.95
Highest	9.8	44.9	-855	-8406	35.8	-0.24	-1.08
Total (3)	30.8	28.2	-761	-23456	100.0	-0.37	-1.84
Top 10%	4.2	38.6	-822	-3474	14.8	-0.14	-0.61
Top 5%	1.7	31.1	-770	-1310	5.6	-0.07	-0.32
Top 1%	0.1	5.9	-631	-41	0.2	-0.00	-0.02

Department of the Treasury  
Office of Tax Analysis

March 13, 1995

- (1) This table distributes the estimated change in taxes due to the proposed \$500 nonrefundable credit for children aged 17 and under which phases out between AGIs of \$200,000 and \$250,000 on all returns, regardless of filing status. The credit would be taken before the EITC. The credit amount and phaseout range would be indexed for inflation.
- (2) Family Economic Income (FEI) is a broad-based income concept. FEI is constructed by adding to AGI unreported and underreported income; IRA and Keogh deductions; nontaxable transfer payments such as Social Security and AFDC; employer-provided fringe benefits; inside build-up on pensions, IRAs, Keoghs, and life insurance; tax-exempt interest; and imputed rent on owner-occupied housing. Capital gains are computed on an accrual basis, adjusted for inflation to the extent reliable data allow. Inflationary losses of lenders are subtracted and gains of borrowers are added. There is also an adjustment for accelerated depreciation of noncorporate businesses. FEI is shown on a family rather than a tax-return basis. The economic incomes of all members of a family unit are added to arrive at the family's economic income used in the distributions.
- (3) Families with negative incomes are excluded from the lowest quintile but included in the total line.

NOTE: Quintiles begin at FEI of: Second \$15,604; Third \$29,717; Fourth \$48,660; Highest \$79,056;  
Top 10% \$108,704; Top 5% \$145,412; Top 1% \$349,438.

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UNITED STATES DEPARTMENT OF LABOR  
OFFICE OF THE SECRETARY

To: Jon Orszag

fr: RBK

Good!

I assume

(1) ~~Do~~ these Treasury numbers on the Capital Gains Tax cut apply to the cut in the Contract? Label should be: "Who Gains from ~~the Capital Gains Tax~~ Cut in the Contract?"

(2) Has Treasury analyzed Archer's latest tax ideas?

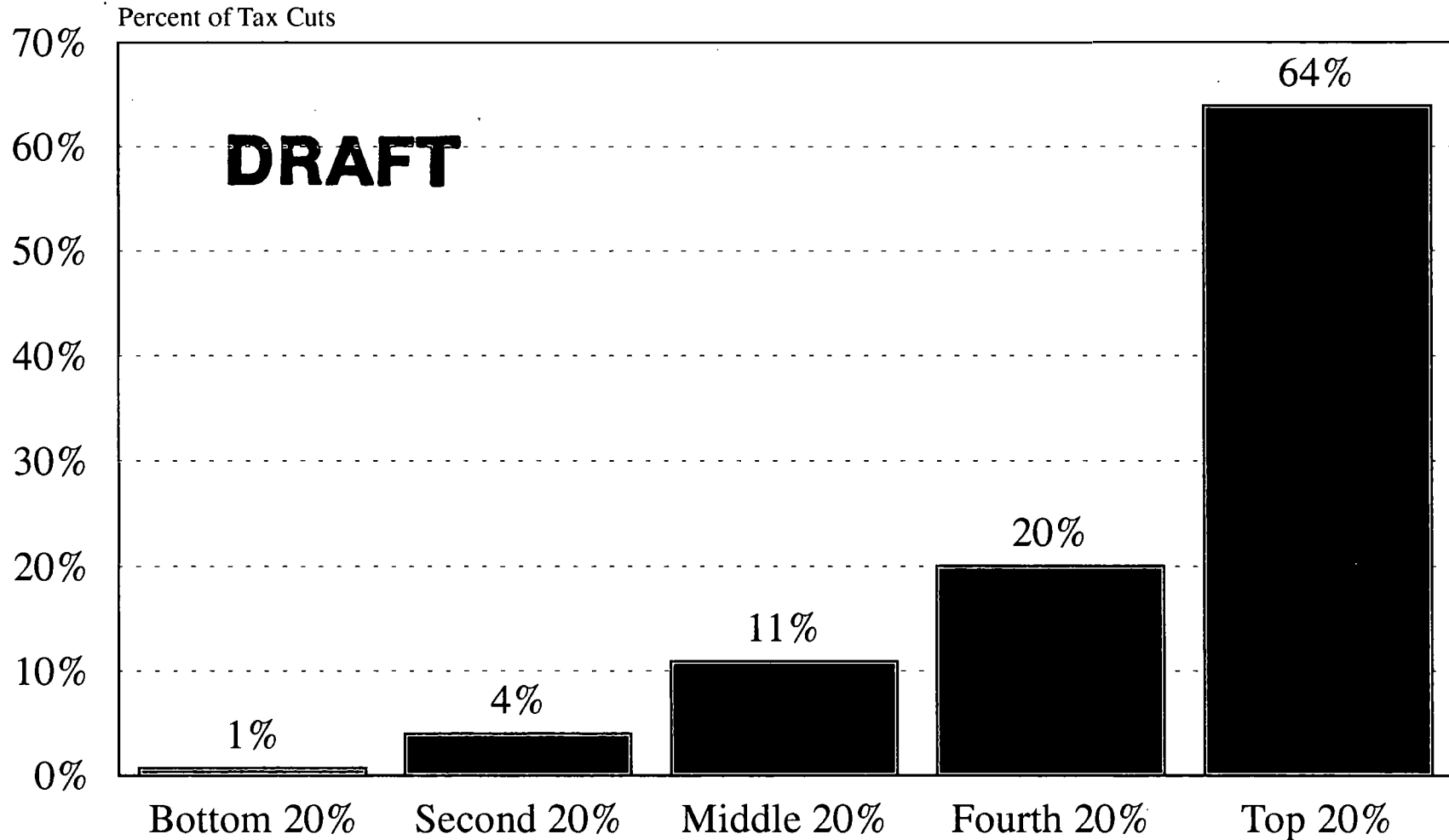
(3) Could we make the columns in rough proportion ~~to the~~ (in width) to size of group — in ~~the~~ quintile graphs?

WORKING FOR AMERICA'S WORKFORCE

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# Who Gains from the "Contract with America"?

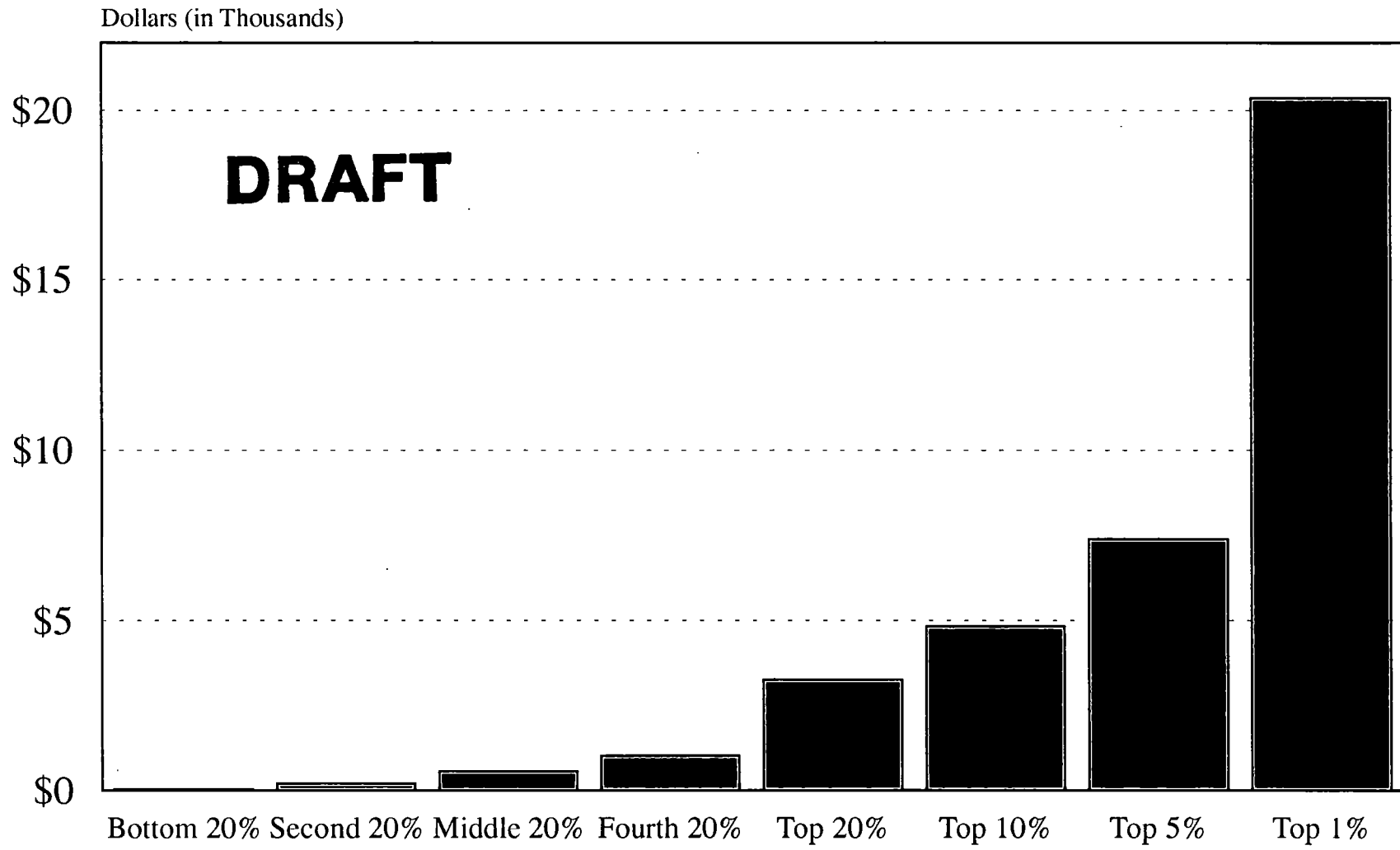
## Distribution of Tax Cuts by Family Income Quintile



Source: Office of Tax Analysis, Department of Treasury.

# Who Gains from the "Contract with America"?

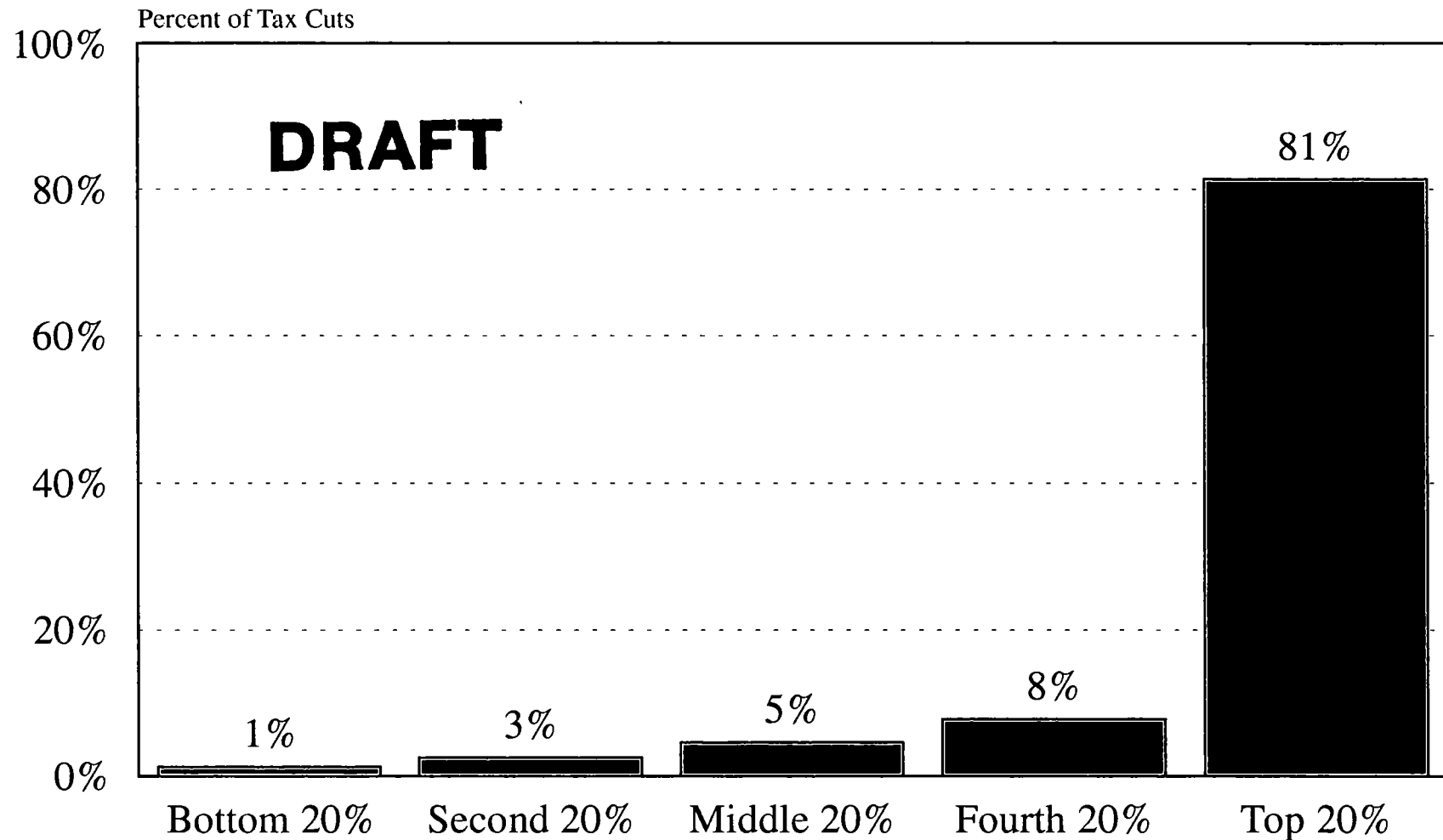
## Average Tax Cut per Family by Income Group



Source: Office of Tax Analysis, Department of Treasury.

# Who Gains from a Capital Gains Tax Cut?

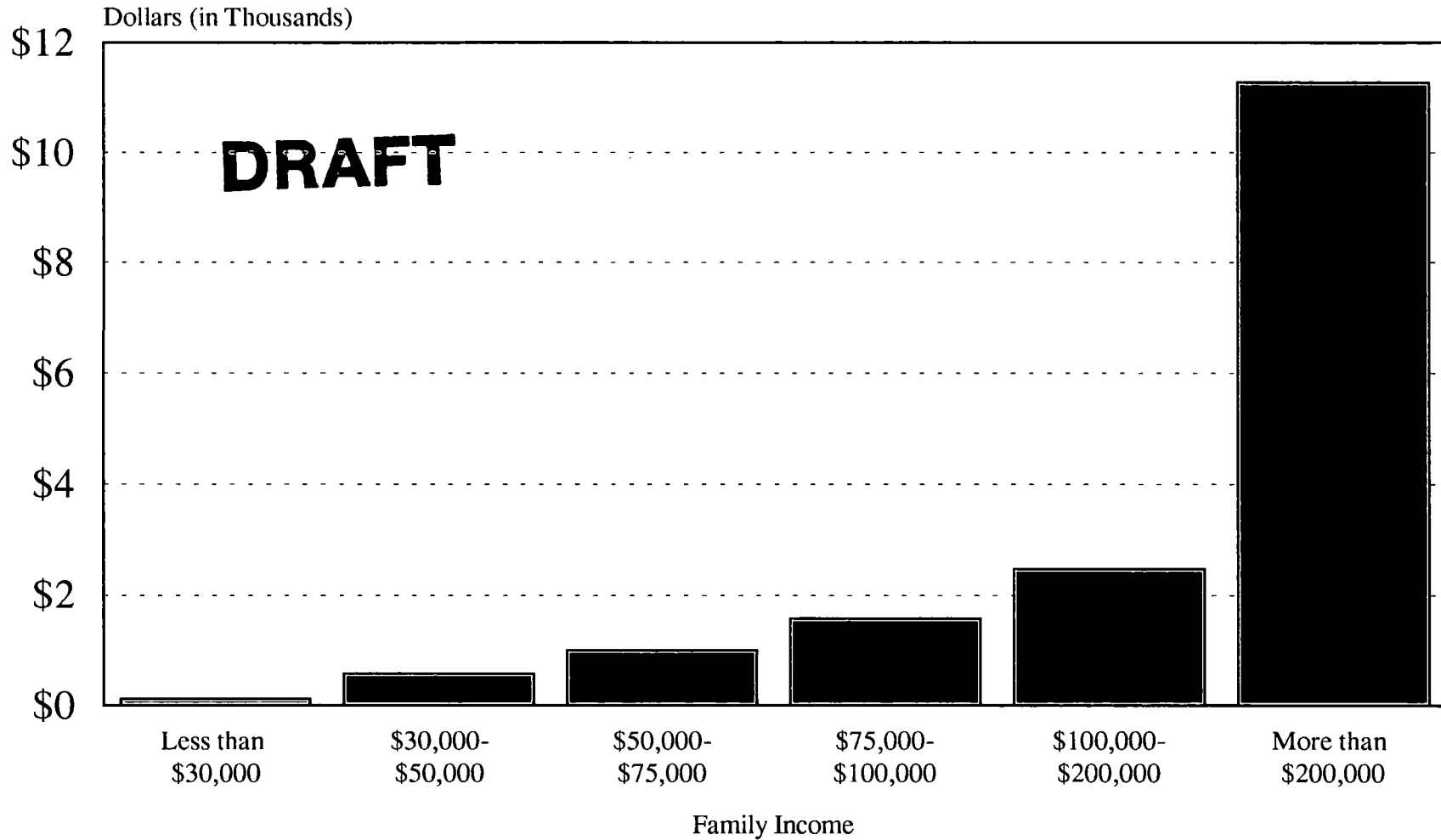
## Distribution of Tax Cut by Family Income Quintile



Source: Office of Tax Analysis, Department of Treasury. Analysis assumes 50% exclusion and indexing of Capital Gains for Individuals.

# Who Gains from the "Contract with America"?

## Average Tax Cut per Family from the Contract's Tax Package



Source: Office of Tax Analysis, Department of Treasury.

**Congress of the United States**  
JOINT COMMITTEE ON TAXATION  
Washington, DC 20515-6453

**MEMORANDUM**

**MAR 11 1995**

**TO:** Janice Mays  
**FROM:** Kenneth J. Kies  
**SUBJECT:** Distribution of Taxpayers by Income

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In response to your request of March 9, 1995, we are providing the attached tables. Tables #D-95-23 through #D-95-31 provide distributional analyses for certain tax provisions for the "Contract With America Tax Relief Act of 1995" as a package and separately. Table #D-95-32 shows the total number of taxpayers by income category. Table #D-95-33 shows the estimated number of taxpayers affected by certain provisions included in the attached distribution analyses. In the case of the American Dream Savings Accounts, the capital gains provisions, and the long-term care provisions, we are unable to provide the number of taxpayers affected.

Attachment [Tables: #D-95-23, #D-95-24, #D-95-25,  
#D-95-26, #D-95-27, #D-95-28,  
#D-95-29, #D-95-30, #D-95-31,  
#D-95-32 & #D-95-33]

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**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1995**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$2	(5)	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	7	(5)	36	3.2%	36	3.2%	9.5%	9.4%
20,000 to 30,000.....	6	(5)	72	6.4%	72	6.4%	14.2%	14.1%
30,000 to 40,000.....	49	(5)	100	9.0%	101	8.9%	17.3%	17.2%
40,000 to 50,000.....	201	0.2%	106	9.5%	106	9.4%	19.4%	19.1%
50,000 to 75,000.....	1,497	0.7%	227	20.3%	228	20.2%	21.2%	20.9%
75,000 to 100,000.....	1,024	0.6%	161	14.4%	162	14.3%	23.2%	22.7%
100,000 to 200,000.....	3,400	1.8%	188	16.8%	191	16.9%	24.4%	23.5%
200,000 and over.....	7,466	3.4%	222	19.8%	229	20.2%	29.8%	27.6%
<b>Total, All Taxpayers...</b>	<b>\$13,651</b>	<b>1.2%</b>	<b>\$1,119</b>	<b>100.0%</b>	<b>\$1,133</b>	<b>100.0%</b>	<b>20.8%</b>	<b>20.3%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1996**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$21	0.3%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-787	-2.1%	37	3.1%	36	3.1%	9.3%	9.1%
20,000 to 30,000.....	-2,248	-3.0%	74	6.3%	72	6.3%	14.0%	13.5%
30,000 to 40,000.....	-3,923	-3.7%	105	8.9%	101	8.8%	17.2%	16.5%
40,000 to 50,000.....	-3,980	-3.6%	111	9.5%	107	9.3%	19.1%	18.3%
50,000 to 75,000.....	-8,178	-3.4%	237	20.3%	229	20.1%	21.0%	20.1%
75,000 to 100,000.....	-4,435	-2.6%	169	14.4%	165	14.4%	23.1%	22.2%
100,000 to 200,000.....	-4,023	-2.0%	201	17.2%	197	17.2%	24.3%	23.1%
200,000 and over.....	-2,092	-0.9%	230	19.6%	228	19.9%	29.8%	28.0%
<b>Total, All Taxpayers...</b>	<b>-\$29,645</b>	<b>-2.5%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,142</b>	<b>100.0%</b>	<b>20.6%</b>	<b>19.8%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1997**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$11	-0.1%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-893	-2.3%	38	3.1%	37	3.1%	9.2%	8.9%
20,000 to 30,000.....	-2,332	-3.0%	77	6.2%	74	6.2%	13.9%	13.5%
30,000 to 40,000.....	-4,124	-3.8%	109	8.9%	105	8.8%	17.1%	16.4%
40,000 to 50,000.....	-4,286	-3.7%	117	9.5%	112	9.4%	19.0%	18.2%
50,000 to 75,000.....	-9,093	-3.7%	247	20.1%	238	19.9%	20.9%	20.0%
75,000 to 100,000.....	-5,492	-3.1%	180	14.6%	174	14.6%	23.1%	22.1%
100,000 to 200,000.....	-5,915	-2.8%	213	17.3%	207	17.3%	24.3%	23.1%
200,000 and over.....	-4,779	-2.0%	243	19.7%	238	19.9%	29.9%	28.2%
<b>Total, All Taxpayers...</b>	<b>-\$36,927</b>	<b>-3.0%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,195</b>	<b>100.0%</b>	<b>20.6%</b>	<b>19.7%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1998**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$52	-0.6%	\$9	0.7%	\$9	0.7%	8.2%	8.1%
10,000 to 20,000.....	-1,040	-2.6%	39	3.0%	38	3.1%	9.1%	8.8%
20,000 to 30,000.....	-2,615	-3.3%	80	6.1%	77	6.2%	13.9%	13.4%
30,000 to 40,000.....	-4,636	-4.0%	115	8.9%	110	8.8%	17.0%	16.3%
40,000 to 50,000.....	-4,884	-4.0%	122	9.4%	117	9.3%	18.8%	18.0%
50,000 to 75,000.....	-10,445	-4.1%	257	19.8%	246	19.7%	20.7%	19.8%
75,000 to 100,000.....	-6,563	-3.4%	192	14.8%	185	14.8%	23.0%	22.0%
100,000 to 200,000.....	-7,155	-3.2%	226	17.4%	218	17.5%	24.2%	22.9%
200,000 and over.....	-6,071	-2.4%	257	19.8%	251	20.0%	29.9%	27.9%
<b>Total, All Taxpayers...</b>	<b>-\$43,460</b>	<b>-3.4%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,251</b>	<b>100.0%</b>	<b>20.6%</b>	<b>19.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1999**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$97	-1.1%	\$9	0.7%	\$9	0.7%	8.4%	8.3%
10,000 to 20,000.....	-1,165	-2.9%	41	3.0%	40	3.0%	9.2%	8.9%
20,000 to 30,000.....	-2,781	-3.4%	83	6.1%	80	6.1%	13.6%	13.1%
30,000 to 40,000.....	-4,817	-4.0%	120	8.8%	115	8.8%	16.9%	16.2%
40,000 to 50,000.....	-5,113	-4.0%	126	9.3%	121	9.2%	18.6%	17.8%
50,000 to 75,000.....	-11,256	-4.2%	270	19.8%	259	19.7%	20.6%	19.6%
75,000 to 100,000.....	-7,418	-3.7%	202	14.8%	195	14.8%	22.9%	21.8%
100,000 to 200,000.....	-8,316	-3.5%	240	17.6%	232	17.6%	24.2%	22.7%
200,000 and over.....	-7,123	-2.6%	271	19.9%	264	20.1%	29.9%	27.8%
<b>Total, All Taxpayers...</b>	<b>-\$48,086</b>	<b>-3.5%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,314</b>	<b>100.0%</b>	<b>20.5%</b>	<b>19.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE TAX  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 2000**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$211	-2.3%	\$9	0.6%	\$9	0.6%	8.6%	8.3%
10,000 to 20,000.....	-1,409	-3.4%	42	2.9%	41	2.9%	9.0%	8.7%
20,000 to 30,000.....	-3,304	-3.9%	86	6.0%	82	6.0%	13.6%	13.0%
30,000 to 40,000.....	-5,407	-4.3%	125	8.7%	120	8.7%	16.8%	16.0%
40,000 to 50,000.....	-5,860	-4.4%	133	9.3%	127	9.2%	18.5%	17.6%
50,000 to 75,000.....	-12,433	-4.4%	280	19.6%	268	19.4%	20.5%	19.4%
75,000 to 100,000.....	-8,570	-4.0%	215	15.0%	206	15.0%	22.8%	21.6%
100,000 to 200,000.....	-9,466	-3.7%	255	17.8%	245	17.8%	24.1%	22.6%
200,000 and over.....	-8,413	-2.9%	289	20.2%	281	20.3%	30.0%	27.8%
<b>Total, All Taxpayers...</b>	<b>-\$55,073</b>	<b>-3.8%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,379</b>	<b>100.0%</b>	<b>20.5%</b>	<b>19.4%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the family tax credit, the marriage penalty credit, American Dream Savings Accounts, spousal IRAs, repeal of the Social Security Benefit tax increase, long term care, capital gains deduction and indexing, the credit for adoption expense, and the custodial care credit.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE FAMILY TAX CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$2	(4)	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-751	-2.0%	37	3.1%	36	3.1%	9.3%	9.1%
20,000 to 30,000.....	-2,264	-3.1%	74	6.3%	72	6.3%	14.0%	13.5%
30,000 to 40,000.....	-3,742	-3.6%	105	8.9%	101	8.8%	17.2%	16.6%
40,000 to 50,000.....	-3,623	-3.3%	111	9.5%	107	9.3%	19.1%	18.5%
50,000 to 75,000.....	-7,036	-3.0%	237	20.3%	230	20.1%	21.0%	20.3%
75,000 to 100,000.....	-3,419	-2.0%	169	14.4%	166	14.4%	23.1%	22.7%
100,000 to 200,000.....	-2,182	-1.1%	201	17.2%	199	17.3%	24.3%	24.0%
200,000 and over.....	-166	-0.1%	230	19.6%	230	20.0%	29.8%	29.7%
<b>Total, All Taxpayers...</b>	<b>-\$23,184</b>	<b>-2.0%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,148</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.2%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
- (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
- (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
- (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE FAMILY TAX CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1997**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$2	(4)	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-785	-2.1%	38	3.1%	37	3.1%	9.2%	9.0%
20,000 to 30,000.....	-2,289	-3.0%	77	6.2%	75	6.2%	13.9%	13.5%
30,000 to 40,000.....	-3,805	-3.5%	109	8.9%	106	8.7%	17.1%	16.5%
40,000 to 50,000.....	-3,692	-3.2%	117	9.5%	113	9.4%	19.0%	18.4%
50,000 to 75,000.....	-7,071	-2.9%	247	20.1%	240	19.9%	20.9%	20.3%
75,000 to 100,000.....	-3,521	-2.0%	180	14.6%	176	14.6%	23.1%	22.6%
100,000 to 200,000.....	-2,239	-1.1%	213	17.3%	210	17.4%	24.3%	24.0%
200,000 and over.....	-168	-0.1%	243	19.7%	242	20.1%	29.9%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$23,570</b>	<b>-1.9%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,208</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.2%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE FAMILY TAX CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1998**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$2	(4)	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-849	-2.2%	39	3.0%	38	3.0%	9.1%	8.9%
20,000 to 30,000.....	-2,481	-3.1%	80	6.1%	77	6.1%	13.9%	13.4%
30,000 to 40,000.....	-4,208	-3.7%	115	8.9%	110	8.7%	17.0%	16.4%
40,000 to 50,000.....	-4,078	-3.4%	122	9.4%	118	9.3%	18.8%	18.2%
50,000 to 75,000.....	-7,803	-3.0%	257	19.8%	249	19.6%	20.7%	20.1%
75,000 to 100,000.....	-3,984	-2.1%	192	14.8%	188	14.8%	23.0%	22.6%
100,000 to 200,000.....	-2,546	-1.1%	226	17.4%	223	17.6%	24.2%	23.9%
200,000 and over.....	-198	-0.1%	257	19.8%	257	20.2%	29.9%	29.9%
<b>Total, All Taxpayers....</b>	<b>-\$26,149</b>	<b>-2.0%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,269</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.1%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE FAMILY TAX CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1999**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$1	(4)	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	-891	-2.2%	41	3.0%	40	3.0%	9.2%	9.0%
20,000 to 30,000.....	-2,559	-3.1%	83	6.1%	80	6.0%	13.6%	13.2%
30,000 to 40,000.....	-4,269	-3.6%	120	8.8%	116	8.7%	16.9%	16.3%
40,000 to 50,000.....	-4,060	-3.2%	126	9.3%	122	9.2%	18.6%	18.0%
50,000 to 75,000.....	-7,943	-2.9%	270	19.8%	262	19.6%	20.6%	20.0%
75,000 to 100,000.....	-4,081	-2.0%	202	14.8%	198	14.8%	22.9%	22.5%
100,000 to 200,000.....	-2,615	-1.1%	240	17.6%	237	17.8%	24.2%	23.9%
200,000 and over.....	-198	-0.1%	271	19.9%	271	20.3%	29.9%	29.9%
<b>Total, All Taxpayers....</b>	<b>-\$26,618</b>	<b>-2.0%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,336</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.1%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE FAMILY TAX CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 2000**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$1	(4)	\$9	0.6%	\$9	0.7%	8.6%	8.5%
10,000 to 20,000.....	-934	-2.2%	42	2.9%	41	2.9%	9.0%	8.8%
20,000 to 30,000.....	-2,626	-3.1%	86	6.0%	83	5.9%	13.6%	13.2%
30,000 to 40,000.....	-4,329	-3.5%	125	8.7%	121	8.6%	16.8%	16.2%
40,000 to 50,000.....	-4,155	-3.1%	133	9.3%	129	9.1%	18.5%	17.9%
50,000 to 75,000.....	-7,912	-2.8%	280	19.6%	272	19.4%	20.5%	19.9%
75,000 to 100,000.....	-4,208	-2.0%	215	15.0%	211	15.0%	22.8%	22.4%
100,000 to 200,000.....	-2,670	-1.0%	255	17.8%	252	17.9%	24.1%	23.9%
200,000 and over.....	-204	-0.1%	289	20.2%	289	20.5%	30.0%	30.0%
<b>Total, All Taxpayers...</b>	<b>-\$27,038</b>	<b>-1.9%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,407</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.1%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1995**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law Percent	Proposal Percent
Less than \$10,000.....	\$2	(5)	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	7	(5)	36	3.2%	36	3.2%	9.5%	9.4%
20,000 to 30,000.....	6	(5)	72	6.4%	72	6.4%	14.2%	14.1%
30,000 to 40,000.....	49	(5)	100	9.0%	101	8.9%	17.3%	17.2%
40,000 to 50,000.....	201	0.2%	106	9.5%	106	9.4%	19.4%	19.1%
50,000 to 75,000.....	1,497	0.7%	227	20.3%	228	20.2%	21.2%	20.9%
75,000 to 100,000.....	1,024	0.6%	161	14.4%	162	14.3%	23.2%	22.7%
100,000 to 200,000.....	3,400	1.8%	188	16.8%	191	16.9%	24.4%	23.5%
200,000 and over.....	7,466	3.4%	222	19.8%	229	20.2%	29.8%	27.6%
<b>Total, All Taxpayers...</b>	<b>\$13,651</b>	<b>1.2%</b>	<b>\$1,119</b>	<b>100.0%</b>	<b>\$1,133</b>	<b>100.0%</b>	<b>20.8%</b>	<b>20.3%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) Includes the capital gains deduction and indexing.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The 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.

(5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1996**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$2	0.0%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-11	0.0%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	-64	-0.1%	74	6.3%	74	6.3%	14.0%	13.9%
30,000 to 40,000.....	-110	-0.1%	105	8.9%	105	9.0%	17.2%	17.1%
40,000 to 50,000.....	-162	-0.1%	111	9.5%	111	9.5%	19.1%	19.0%
50,000 to 75,000.....	-386	-0.2%	237	20.3%	237	20.3%	21.0%	20.8%
75,000 to 100,000.....	-282	-0.2%	169	14.4%	169	14.5%	23.1%	22.7%
100,000 to 200,000.....	-1,000	-0.5%	201	17.2%	200	17.1%	24.3%	23.5%
200,000 and over.....	-1,628	-0.7%	230	19.6%	228	19.5%	29.8%	28.1%
<b>Total, All Taxpayers....</b>	<b>-\$3,643</b>	<b>-0.3%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,168</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.2%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the capital gains deduction and indexing.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1997**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$3	0.0%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-19	-0.1%	38	3.1%	38	3.1%	9.2%	9.1%
20,000 to 30,000.....	-80	-0.1%	77	6.2%	77	6.3%	13.9%	13.9%
30,000 to 40,000.....	-194	-0.2%	109	8.9%	109	8.9%	17.1%	17.0%
40,000 to 50,000.....	-278	-0.2%	117	9.5%	116	9.5%	19.0%	18.9%
50,000 to 75,000.....	-713	-0.3%	247	20.1%	246	20.1%	20.9%	20.7%
75,000 to 100,000.....	-724	-0.4%	180	14.6%	179	14.7%	23.1%	22.7%
100,000 to 200,000.....	-2,262	-1.1%	213	17.3%	210	17.2%	24.3%	23.5%
200,000 and over.....	-4,064	-1.7%	243	19.7%	239	19.5%	29.9%	28.3%
<b>Total, All Taxpayers...</b>	<b>-\$8,337</b>	<b>-0.7%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,223</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.2%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) Includes the capital gains deduction and indexing.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The 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.

(5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1998**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$3	0.0%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-23	-0.1%	39	3.0%	39	3.1%	9.1%	9.0%
20,000 to 30,000.....	-95	-0.1%	80	6.1%	80	6.2%	13.9%	13.8%
30,000 to 40,000.....	-230	-0.2%	115	8.9%	114	8.9%	17.0%	16.9%
40,000 to 50,000.....	-330	-0.3%	122	9.4%	121	9.4%	18.8%	18.7%
50,000 to 75,000.....	-862	-0.3%	257	19.8%	256	19.9%	20.7%	20.5%
75,000 to 100,000.....	-915	-0.5%	192	14.8%	191	14.8%	23.0%	22.6%
100,000 to 200,000.....	-2,756	-1.2%	226	17.4%	223	17.4%	24.2%	23.3%
200,000 and over.....	-5,134	-2.0%	257	19.8%	252	19.6%	29.9%	28.0%
<b>Total, All Taxpayers...</b>	<b>-\$10,347</b>	<b>-0.8%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,284</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.1%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the capital gains deduction and indexing.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1999**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$3	0.0%	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	-25	-0.1%	41	3.0%	41	3.0%	9.2%	9.1%
20,000 to 30,000.....	-106	-0.1%	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-259	-0.2%	120	8.8%	120	8.9%	16.9%	16.8%
40,000 to 50,000.....	-397	-0.3%	126	9.3%	126	9.3%	18.6%	18.5%
50,000 to 75,000.....	-1,003	-0.4%	270	19.8%	269	19.9%	20.6%	20.4%
75,000 to 100,000.....	-1,143	-0.6%	202	14.8%	201	14.9%	22.9%	22.5%
100,000 to 200,000.....	-3,302	-1.4%	240	17.6%	237	17.5%	24.2%	23.2%
200,000 and over.....	-5,950	-2.2%	271	19.9%	265	19.6%	29.9%	27.9%
<b>Total, All Taxpayers...</b>	<b>-\$12,186</b>	<b>-0.9%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,350</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.0%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the capital gains deduction and indexing.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The 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.
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE CAPITAL GAINS  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 2000**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$4	0.0%	\$9	0.6%	\$9	0.6%	8.6%	8.5%
10,000 to 20,000.....	-28	-0.1%	42	2.9%	42	3.0%	9.0%	9.0%
20,000 to 30,000.....	-119	-0.1%	86	6.0%	86	6.0%	13.6%	13.5%
30,000 to 40,000.....	-295	-0.2%	125	8.7%	125	8.8%	16.8%	16.7%
40,000 to 50,000.....	-435	-0.3%	133	9.3%	132	9.3%	18.5%	18.3%
50,000 to 75,000.....	-1,114	-0.4%	280	19.6%	279	19.7%	20.5%	20.2%
75,000 to 100,000.....	-1,328	-0.6%	215	15.0%	214	15.1%	22.8%	22.4%
100,000 to 200,000.....	-3,687	-1.4%	255	17.8%	251	17.7%	24.1%	23.1%
200,000 and over.....	-6,949	-2.4%	289	20.2%	282	19.9%	30.0%	27.9%
<b>Total, All Taxpayers...</b>	<b>-\$13,960</b>	<b>-1.0%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,420</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.0%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

(1) Includes the capital gains deduction and indexing.

(2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.

(3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.

(4) The 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.

(5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE AMERICAN DREAM SAVINGS  
ACCOUNTS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1996**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$43	0.5%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	63	0.2%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	313	0.4%	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	370	0.4%	105	8.9%	105	9.0%	17.2%	17.2%
40,000 to 50,000.....	336	0.3%	111	9.5%	111	9.5%	19.1%	19.2%
50,000 to 75,000.....	411	0.2%	237	20.3%	238	20.3%	21.0%	21.0%
75,000 to 100,000.....	211	0.1%	169	14.4%	169	14.4%	23.1%	23.2%
100,000 to 200,000.....	65	(5)	201	17.2%	201	17.1%	24.3%	24.3%
200,000 and over.....	2	(5)	230	19.6%	230	19.6%	29.8%	29.8%
<b>Total, All Taxpayers....</b>	<b>\$1,814</b>	<b>0.2%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,173</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.7%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the spousal IRA provision.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE AMERICAN DREAM SAVINGS  
ACCOUNTS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1997**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$16	0.2%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	11	(5)	38	3.1%	38	3.1%	9.2%	9.2%
20,000 to 30,000.....	278	0.4%	77	6.2%	77	6.3%	13.9%	14.0%
30,000 to 40,000.....	347	0.3%	109	8.9%	110	8.9%	17.1%	17.1%
40,000 to 50,000.....	291	0.2%	117	9.5%	117	9.5%	19.0%	19.0%
50,000 to 75,000.....	294	0.1%	247	20.1%	247	20.1%	20.9%	20.9%
75,000 to 100,000.....	138	0.1%	180	14.6%	180	14.6%	23.1%	23.1%
100,000 to 200,000.....	-12	(5)	213	17.3%	213	17.2%	24.3%	24.3%
200,000 and over.....	-51	(5)	243	19.7%	243	19.7%	29.9%	29.8%
<b>Total, All Taxpayers...</b>	<b>\$1,310</b>	<b>0.1%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,233</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the spousal IRA provision.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE AMERICAN DREAM SAVINGS  
ACCOUNTS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1998**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$23	-0.3%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-62	-0.2%	39	3.0%	39	3.0%	9.1%	9.0%
20,000 to 30,000.....	212	0.3%	80	6.1%	80	6.2%	13.9%	13.9%
30,000 to 40,000.....	294	0.3%	115	8.9%	115	8.9%	17.0%	17.0%
40,000 to 50,000.....	212	0.2%	122	9.4%	122	9.4%	18.8%	18.8%
50,000 to 75,000.....	115	(5)	257	19.8%	257	19.8%	20.7%	20.7%
75,000 to 100,000.....	29	(5)	192	14.8%	192	14.8%	23.0%	23.0%
100,000 to 200,000.....	-118	-0.1%	226	17.4%	225	17.4%	24.2%	24.2%
200,000 and over.....	-122	(5)	257	19.8%	257	19.8%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>\$536</b>	<b>(5)</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the spousal IRA provision.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE AMERICAN DREAM SAVINGS  
ACCOUNTS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1999**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$67	-0.8%	\$9	0.7%	\$9	0.6%	8.4%	8.3%
10,000 to 20,000.....	-145	-0.4%	41	3.0%	41	3.0%	9.2%	9.1%
20,000 to 30,000.....	136	0.2%	83	6.1%	83	6.1%	13.6%	13.7%
30,000 to 40,000.....	233	0.2%	120	8.8%	120	8.8%	16.9%	17.0%
40,000 to 50,000.....	121	0.1%	126	9.3%	127	9.3%	18.6%	18.6%
50,000 to 75,000.....	-90	(5)	270	19.8%	270	19.8%	20.6%	20.6%
75,000 to 100,000.....	-95	(5)	202	14.8%	202	14.8%	22.9%	22.9%
100,000 to 200,000.....	-239	-0.1%	240	17.6%	240	17.6%	24.2%	24.1%
200,000 and over.....	-203	-0.1%	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$349</b>	<b>(5)</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- 
- (1) Includes the spousal IRA provision.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE AMERICAN DREAM SAVINGS  
ACCOUNTS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 2000**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$178	-1.9%	\$9	0.6%	\$9	0.6%	8.6%	8.4%
10,000 to 20,000.....	-334	-0.8%	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-292	-0.3%	86	6.0%	85	6.0%	13.6%	13.5%
30,000 to 40,000.....	-228	-0.2%	125	8.7%	125	8.7%	16.8%	16.8%
40,000 to 50,000.....	-352	-0.3%	133	9.3%	132	9.3%	18.5%	18.4%
50,000 to 75,000.....	-813	-0.3%	280	19.6%	280	19.6%	20.5%	20.4%
75,000 to 100,000.....	-496	-0.2%	215	15.0%	215	15.0%	22.8%	22.8%
100,000 to 200,000.....	-489	-0.2%	255	17.8%	254	17.8%	24.1%	24.1%
200,000 and over.....	-328	-0.1%	289	20.2%	289	20.2%	30.0%	30.0%
<b>Total, All Taxpayers....</b>	<b>-\$3,512</b>	<b>-0.2%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,430</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.4%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the spousal IRA provision.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2)."
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE MARRIAGE PENALTY RELIEF  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-9	(4)	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	-92	-0.1%	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	-258	-0.2%	105	8.9%	105	8.9%	17.2%	17.1%
40,000 to 50,000.....	-312	-0.3%	111	9.5%	110	9.4%	19.1%	19.1%
50,000 to 75,000.....	-509	-0.2%	237	20.3%	237	20.2%	21.0%	20.9%
75,000 to 100,000.....	-415	-0.2%	169	14.4%	169	14.4%	23.1%	23.1%
100,000 to 200,000.....	-319	-0.2%	201	17.2%	201	17.2%	24.3%	24.3%
200,000 and over.....	-55	(4)	230	19.6%	230	19.6%	29.8%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$1,968</b>	<b>-0.2%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,170</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE MARRIAGE PENALTY RELIEF  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1997**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-9	(4)	38	3.1%	38	3.1%	9.2%	9.2%
20,000 to 30,000.....	-92	-0.1%	77	6.2%	77	6.2%	13.9%	13.9%
30,000 to 40,000.....	-257	-0.2%	109	8.9%	109	8.9%	17.1%	17.0%
40,000 to 50,000.....	-311	-0.3%	117	9.5%	116	9.5%	19.0%	18.9%
50,000 to 75,000.....	-502	-0.2%	247	20.1%	247	20.1%	20.9%	20.8%
75,000 to 100,000.....	-427	-0.2%	180	14.6%	180	14.6%	23.1%	23.0%
100,000 to 200,000.....	-323	-0.2%	213	17.3%	212	17.3%	24.3%	24.2%
200,000 and over.....	-57	(4)	243	19.7%	243	19.7%	29.9%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$1,977</b>	<b>-0.2%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,230</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE MARRIAGE PENALTY RELIEF  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1998**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-9	(4)	39	3.0%	39	3.0%	9.1%	9.0%
20,000 to 30,000.....	-94	-0.1%	80	6.1%	80	6.2%	13.9%	13.8%
30,000 to 40,000.....	-259	-0.2%	115	8.9%	114	8.8%	17.0%	17.0%
40,000 to 50,000.....	-311	-0.3%	122	9.4%	121	9.4%	18.8%	18.8%
50,000 to 75,000.....	-499	-0.2%	257	19.8%	256	19.8%	20.7%	20.7%
75,000 to 100,000.....	-437	-0.2%	192	14.8%	191	14.8%	23.0%	23.0%
100,000 to 200,000.....	-330	-0.1%	226	17.4%	225	17.4%	24.2%	24.2%
200,000 and over.....	-58	(4)	257	19.8%	257	19.9%	29.9%	29.9%
<b>Total, All Taxpayers....</b>	<b>-\$1,996</b>	<b>-0.2%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,293</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
- (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
- (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
- (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE MARRIAGE PENALTY RELIEF  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1999**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	-9	(4)	41	3.0%	41	3.0%	9.2%	9.2%
20,000 to 30,000.....	-92	-0.1%	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-262	-0.2%	120	8.8%	120	8.8%	16.9%	16.9%
40,000 to 50,000.....	-306	-0.2%	126	9.3%	126	9.3%	18.6%	18.6%
50,000 to 75,000.....	-507	-0.2%	270	19.8%	269	19.8%	20.6%	20.6%
75,000 to 100,000.....	-442	-0.2%	202	14.8%	202	14.8%	22.9%	22.9%
100,000 to 200,000.....	-337	-0.1%	240	17.6%	240	17.6%	24.2%	24.1%
200,000 and over.....	-59	(4)	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$2,014</b>	<b>-0.1%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,360</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE MARRIAGE PENALTY RELIEF  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 2000**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.6%	\$9	0.6%	8.6%	8.6%
10,000 to 20,000.....	-9	(4)	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-95	-0.1%	86	6.0%	86	6.0%	13.6%	13.6%
30,000 to 40,000.....	-261	-0.2%	125	8.7%	125	8.7%	16.8%	16.8%
40,000 to 50,000.....	-307	-0.2%	133	9.3%	132	9.2%	18.5%	18.4%
50,000 to 75,000.....	-504	-0.2%	280	19.6%	280	19.6%	20.5%	20.5%
75,000 to 100,000.....	-456	-0.2%	215	15.0%	215	15.0%	22.8%	22.8%
100,000 to 200,000.....	-342	-0.1%	255	17.8%	254	17.8%	24.1%	24.1%
200,000 and over.....	-61	(4)	289	20.2%	289	20.2%	30.0%	30.0%
<b>Total, All Taxpayers...</b>	<b>-\$2,034</b>	<b>-0.1%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,432</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE REPEAL OF THE SOCIAL SECURITY  
BENEFITS TAX CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	0	0.0%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	0	0.0%	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	-1	(4)	105	8.9%	105	9.0%	17.2%	17.2%
40,000 to 50,000.....	-41	(4)	111	9.5%	111	9.5%	19.1%	19.1%
50,000 to 75,000.....	-305	-0.1%	237	20.3%	237	20.3%	21.0%	20.9%
75,000 to 100,000.....	-355	-0.2%	169	14.4%	169	14.4%	23.1%	23.1%
100,000 to 200,000.....	-414	-0.2%	201	17.2%	201	17.1%	24.3%	24.2%
200,000 and over.....	-154	-0.1%	230	19.6%	230	19.6%	29.8%	29.7%
<b>Total, All Taxpayers...</b>	<b>-\$1,271</b>	<b>-0.1%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,170</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
- (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
- (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
- (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE REPEAL OF THE SOCIAL SECURITY  
BENEFITS TAX CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1997**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	0	0.0%	38	3.1%	38	3.1%	9.2%	9.2%
20,000 to 30,000.....	-1	(4)	77	6.2%	77	6.3%	13.9%	13.9%
30,000 to 40,000.....	-5	(4)	109	8.9%	109	8.9%	17.1%	17.1%
40,000 to 50,000.....	-96	-0.1%	117	9.5%	117	9.5%	19.0%	19.0%
50,000 to 75,000.....	-699	-0.3%	247	20.1%	246	20.1%	20.9%	20.8%
75,000 to 100,000.....	-760	-0.4%	180	14.6%	179	14.6%	23.1%	23.0%
100,000 to 200,000.....	-869	-0.4%	213	17.3%	212	17.2%	24.3%	24.2%
200,000 and over.....	-326	-0.1%	243	19.7%	242	19.7%	29.9%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$2,756</b>	<b>-0.2%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,229</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE REPEAL OF THE SOCIAL SECURITY  
BENEFITS TAX CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1998**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	0	0.0%	39	3.0%	39	3.0%	9.1%	9.1%
20,000 to 30,000.....	-1	(4)	80	6.1%	80	6.2%	13.9%	13.9%
30,000 to 40,000.....	-10	(4)	115	8.9%	115	8.9%	17.0%	17.0%
40,000 to 50,000.....	-161	-0.1%	122	9.4%	121	9.4%	18.8%	18.8%
50,000 to 75,000.....	-965	-0.4%	257	19.8%	256	19.8%	20.7%	20.7%
75,000 to 100,000.....	-1,031	-0.5%	192	14.8%	190	14.8%	23.0%	22.9%
100,000 to 200,000.....	-1,157	-0.5%	226	17.4%	224	17.4%	24.2%	24.1%
200,000 and over.....	-427	-0.2%	257	19.8%	256	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$3,752</b>	<b>-0.3%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,291</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

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- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE REPEAL OF THE SOCIAL SECURITY  
BENEFITS TAX CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1999**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	0	0.0%	41	3.0%	41	3.0%	9.2%	9.2%
20,000 to 30,000.....	-1	(4)	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-26	(4)	120	8.8%	120	8.9%	16.9%	16.9%
40,000 to 50,000.....	-247	-0.2%	126	9.3%	126	9.3%	18.6%	18.6%
50,000 to 75,000.....	-1,247	-0.5%	270	19.8%	269	19.8%	20.6%	20.5%
75,000 to 100,000.....	-1,407	-0.7%	202	14.8%	201	14.8%	22.9%	22.8%
100,000 to 200,000.....	-1,524	-0.6%	240	17.6%	238	17.6%	24.2%	24.0%
200,000 and over.....	-549	-0.2%	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$5,001</b>	<b>-0.4%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,357</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.4%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE REPEAL OF THE SOCIAL SECURITY  
BENEFITS TAX CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 2000**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.0%	\$9	0.6%	\$9	0.6%	8.6%	8.6%
10,000 to 20,000.....	0	0.0%	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-2	(4)	86	6.0%	86	6.0%	13.6%	13.6%
30,000 to 40,000.....	-53	(4)	125	8.7%	125	8.8%	16.8%	16.8%
40,000 to 50,000.....	-370	-0.3%	133	9.3%	132	9.3%	18.5%	18.4%
50,000 to 75,000.....	-1,590	-0.6%	280	19.6%	279	19.5%	20.5%	20.4%
75,000 to 100,000.....	-1,799	-0.8%	215	15.0%	213	14.9%	22.8%	22.7%
100,000 to 200,000.....	-1,923	-0.8%	255	17.8%	253	17.7%	24.1%	23.9%
200,000 and over.....	-671	-0.2%	289	20.2%	288	20.2%	30.0%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$6,408</b>	<b>-0.4%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,427</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.4%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE LONG TERM CARE  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1996**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$19	-0.2%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-67	-0.2%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	-96	-0.1%	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	-116	-0.1%	105	8.9%	105	8.9%	17.2%	17.2%
40,000 to 50,000.....	-109	-0.1%	111	9.5%	111	9.4%	19.1%	19.1%
50,000 to 75,000.....	-183	-0.1%	237	20.3%	237	20.3%	21.0%	21.0%
75,000 to 100,000.....	-113	-0.1%	169	14.4%	169	14.4%	23.1%	23.1%
100,000 to 200,000.....	-150	-0.1%	201	17.2%	201	17.2%	24.3%	24.3%
200,000 and over.....	-87	(5)	230	19.6%	230	19.6%	29.8%	29.8%
<b>Total, All Taxpayers....</b>	<b>-\$939</b>	<b>-0.1%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,171</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) Includes the deductibility of long term care expenses and insurance premiums, tax free exchanges of life insurance for long term care policies, and tax free withdrawal from IRAs and 401(k) plans for the purchase of long term care insurance.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE LONG TERM CARE  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1997**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$22	-0.3%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-79	-0.2%	38	3.1%	38	3.1%	9.2%	9.1%
20,000 to 30,000.....	-113	-0.1%	77	6.2%	77	6.2%	13.9%	13.9%
30,000 to 40,000.....	-136	-0.1%	109	8.9%	109	8.9%	17.1%	17.1%
40,000 to 50,000.....	-130	-0.1%	117	9.5%	117	9.5%	19.0%	19.0%
50,000 to 75,000.....	-224	-0.1%	247	20.1%	247	20.1%	20.9%	20.8%
75,000 to 100,000.....	-140	-0.1%	180	14.6%	180	14.6%	23.1%	23.1%
100,000 to 200,000.....	-187	-0.1%	213	17.3%	212	17.3%	24.3%	24.2%
200,000 and over.....	-106	(5)	243	19.7%	243	19.7%	29.9%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$1,137</b>	<b>-0.1%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,230</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the deductibility of long term care expenses and insurance premiums, tax free exchanges of life insurance for long term care policies, and tax free withdrawal from IRAs and 401(k) plans for the purchase of long term care insurance.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE LONG TERM CARE  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1998**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$25	-0.3%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-87	-0.2%	39	3.0%	39	3.0%	9.1%	9.0%
20,000 to 30,000.....	-123	-0.2%	80	6.1%	79	6.1%	13.9%	13.8%
30,000 to 40,000.....	-146	-0.1%	115	8.9%	114	8.8%	17.0%	17.0%
40,000 to 50,000.....	-142	-0.1%	122	9.4%	121	9.4%	18.8%	18.8%
50,000 to 75,000.....	-253	-0.1%	257	19.8%	257	19.8%	20.7%	20.7%
75,000 to 100,000.....	-166	-0.1%	192	14.8%	191	14.8%	23.0%	23.0%
100,000 to 200,000.....	-224	-0.1%	226	17.4%	225	17.4%	24.2%	24.2%
200,000 and over.....	-126	(5)	257	19.8%	257	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$1,291</b>	<b>-0.1%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,293</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the deductibility of long term care expenses and insurance premiums, tax free exchanges of life insurance for long term care policies, and tax free withdrawal from IRAs and 401(k) plans for the purchase of long term care insurance.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE LONG TERM CARE  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 1999**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$26	-0.3%	\$9	0.7%	\$9	0.6%	8.4%	8.3%
10,000 to 20,000.....	-90	-0.2%	41	3.0%	41	3.0%	9.2%	9.1%
20,000 to 30,000.....	-128	-0.2%	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-152	-0.1%	120	8.8%	120	8.8%	16.9%	16.9%
40,000 to 50,000.....	-149	-0.1%	126	9.3%	126	9.3%	18.6%	18.6%
50,000 to 75,000.....	-286	-0.1%	270	19.8%	270	19.8%	20.6%	20.6%
75,000 to 100,000.....	-189	-0.1%	202	14.8%	202	14.8%	22.9%	22.9%
100,000 to 200,000.....	-273	-0.1%	240	17.6%	240	17.6%	24.2%	24.1%
200,000 and over.....	-157	-0.1%	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$1,450</b>	<b>-0.1%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,361</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) Includes the deductibility of long term care expenses and insurance premiums, tax free exchanges of life insurance for long term care policies, and tax free withdrawal from IRAs and 401(k) plans for the purchase of long term care insurance.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

**DISTRIBUTIONAL EFFECTS OF THE LONG TERM CARE  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995 (1)  
Calendar Year 2000**

INCOME CATEGORY (2)	CHANGE IN FEDERAL TAXES (3)		FEDERAL TAXES (3) UNDER PRESENT LAW		FEDERAL TAXES (3) UNDER PROPOSAL		Effective Tax Rate (4)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	-\$28	-0.3%	\$9	0.6%	\$9	0.6%	8.6%	8.5%
10,000 to 20,000.....	-99	-0.2%	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-140	-0.2%	86	6.0%	86	6.0%	13.6%	13.6%
30,000 to 40,000.....	-162	-0.1%	125	8.7%	125	8.7%	16.8%	16.8%
40,000 to 50,000.....	-160	-0.1%	133	9.3%	133	9.3%	18.5%	18.5%
50,000 to 75,000.....	-325	-0.1%	280	19.6%	280	19.6%	20.5%	20.5%
75,000 to 100,000.....	-216	-0.1%	215	15.0%	215	15.0%	22.8%	22.8%
100,000 to 200,000.....	-330	-0.1%	255	17.8%	254	17.8%	24.1%	24.1%
200,000 and over.....	-193	-0.1%	289	20.2%	289	20.2%	30.0%	30.0%
<b>Total, All Taxpayers...</b>	<b>-\$1,652</b>	<b>-0.1%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,432</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- 
- (1) Includes the deductibility of long term care expenses and insurance premiums, tax free exchanges of life insurance for long term care policies, and tax free withdrawal from IRAs and 401(k) plans for the purchase of long term care insurance.
  - (2) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (3) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (4) The effective tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).
  - (5) Less than 0.05%.

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**DISTRIBUTIONAL EFFECTS OF THE ADOPTION CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	0	0.00%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	-2	(4)	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	-23	-0.02%	105	8.9%	105	8.9%	17.2%	17.2%
40,000 to 50,000.....	-39	-0.04%	111	9.5%	111	9.4%	19.1%	19.1%
50,000 to 75,000.....	-112	-0.05%	237	20.3%	237	20.3%	21.0%	21.0%
75,000 to 100,000.....	-42	-0.02%	169	14.4%	169	14.4%	23.1%	23.1%
100,000 to 200,000.....	-11	-0.01%	201	17.2%	201	17.2%	24.3%	24.3%
200,000 and over.....	-3	(4)	230	19.6%	230	19.6%	29.8%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$233</b>	<b>-0.02%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,171</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
- (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
- (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
- (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE ADOPTION CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1997**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	0	0.00%	38	3.1%	38	3.1%	9.2%	9.2%
20,000 to 30,000.....	-2	(4)	77	6.2%	77	6.2%	13.9%	13.9%
30,000 to 40,000.....	-23	-0.02%	109	8.9%	109	8.9%	17.1%	17.1%
40,000 to 50,000.....	-40	-0.03%	117	9.5%	117	9.5%	19.0%	19.0%
50,000 to 75,000.....	-112	-0.05%	247	20.1%	247	20.1%	20.9%	20.8%
75,000 to 100,000.....	-40	-0.02%	180	14.6%	180	14.6%	23.1%	23.1%
100,000 to 200,000.....	-11	-0.01%	213	17.3%	213	17.3%	24.3%	24.3%
200,000 and over.....	-3	(4)	243	19.7%	243	19.7%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$231</b>	<b>-0.02%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,231</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE ADOPTION CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1998**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	0	0.00%	39	3.0%	39	3.0%	9.1%	9.1%
20,000 to 30,000.....	-2	(4)	80	6.1%	80	6.1%	13.9%	13.9%
30,000 to 40,000.....	-24	-0.02%	115	8.9%	115	8.9%	17.0%	17.0%
40,000 to 50,000.....	-42	-0.03%	122	9.4%	122	9.4%	18.8%	18.8%
50,000 to 75,000.....	-112	-0.04%	257	19.8%	257	19.8%	20.7%	20.7%
75,000 to 100,000.....	-38	-0.02%	192	14.8%	191	14.8%	23.0%	23.0%
100,000 to 200,000.....	-10	(4)	226	17.4%	226	17.4%	24.2%	24.2%
200,000 and over.....	-3	(4)	257	19.8%	257	19.8%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$231</b>	<b>-0.02%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,294</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE ADOPTION CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1999**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	0	0.00%	41	3.0%	41	3.0%	9.2%	9.2%
20,000 to 30,000.....	-2	(4)	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-25	-0.02%	120	8.8%	120	8.8%	16.9%	16.9%
40,000 to 50,000.....	-42	-0.03%	126	9.3%	126	9.3%	18.6%	18.6%
50,000 to 75,000.....	-112	-0.04%	270	19.8%	270	19.8%	20.6%	20.6%
75,000 to 100,000.....	-36	-0.02%	202	14.8%	202	14.8%	22.9%	22.9%
100,000 to 200,000.....	-10	(4)	240	17.6%	240	17.6%	24.2%	24.2%
200,000 and over.....	-3	(4)	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$231</b>	<b>-0.02%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation  
Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE ADOPTION CREDIT  
CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 2000**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.6%	\$9	0.6%	8.6%	8.6%
10,000 to 20,000.....	0	0.00%	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-2	(4)	86	6.0%	86	6.0%	13.6%	13.6%
30,000 to 40,000.....	-26	-0.02%	125	8.7%	125	8.7%	16.8%	16.8%
40,000 to 50,000.....	-42	-0.03%	133	9.3%	133	9.3%	18.5%	18.5%
50,000 to 75,000.....	-112	-0.04%	280	19.6%	280	19.6%	20.5%	20.5%
75,000 to 100,000.....	-36	-0.02%	215	15.0%	215	15.0%	22.8%	22.8%
100,000 to 200,000.....	-10	(4)	255	17.8%	254	17.8%	24.1%	24.1%
200,000 and over.....	-3	(4)	289	20.2%	289	20.2%	30.0%	30.0%
<b>Total, All Taxpayers...</b>	<b>-\$231</b>	<b>-0.02%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,433</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE CUSTODIAL CARE  
CREDIT CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$8	0.7%	\$8	0.7%	7.8%	7.8%
10,000 to 20,000.....	-12	-0.03%	37	3.1%	37	3.1%	9.3%	9.3%
20,000 to 30,000.....	-43	-0.06%	74	6.3%	74	6.3%	14.0%	14.0%
30,000 to 40,000.....	-43	-0.04%	105	8.9%	105	8.9%	17.2%	17.2%
40,000 to 50,000.....	-30	-0.03%	111	9.5%	111	9.5%	19.1%	19.1%
50,000 to 75,000.....	-58	-0.02%	237	20.3%	237	20.3%	21.0%	21.0%
75,000 to 100,000.....	-20	-0.01%	169	14.4%	169	14.4%	23.1%	23.1%
100,000 to 200,000.....	-13	-0.01%	201	17.2%	201	17.2%	24.3%	24.3%
200,000 and over.....	-2	(4)	230	19.6%	230	19.6%	29.8%	29.8%
<b>Total, All Taxpayers...</b>	<b>-\$221</b>	<b>-0.02%</b>	<b>\$1,172</b>	<b>100.0%</b>	<b>\$1,171</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE CUSTODIAL CARE  
CREDIT CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1997**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$8	0.7%	\$8	0.7%	8.0%	8.0%
10,000 to 20,000.....	-12	-0.03%	38	3.1%	38	3.1%	9.2%	9.2%
20,000 to 30,000.....	-34	-0.04%	77	6.2%	77	6.2%	13.9%	13.9%
30,000 to 40,000.....	-52	-0.05%	109	8.9%	109	8.9%	17.1%	17.1%
40,000 to 50,000.....	-29	-0.02%	117	9.5%	117	9.5%	19.0%	19.0%
50,000 to 75,000.....	-66	-0.03%	247	20.1%	247	20.1%	20.9%	20.8%
75,000 to 100,000.....	-19	-0.01%	180	14.6%	180	14.6%	23.1%	23.1%
100,000 to 200,000.....	-13	-0.01%	213	17.3%	213	17.3%	24.3%	24.3%
200,000 and over.....	-4	(4)	243	19.7%	243	19.7%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$229</b>	<b>-0.02%</b>	<b>\$1,232</b>	<b>100.0%</b>	<b>\$1,231</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE CUSTODIAL CARE  
CREDIT CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1998**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.7%	\$9	0.7%	8.2%	8.2%
10,000 to 20,000.....	-10	-0.03%	39	3.0%	39	3.0%	9.1%	9.0%
20,000 to 30,000.....	-31	-0.04%	80	6.1%	80	6.1%	13.9%	13.8%
30,000 to 40,000.....	-53	-0.05%	115	8.9%	115	8.8%	17.0%	17.0%
40,000 to 50,000.....	-31	-0.03%	122	9.4%	122	9.4%	18.8%	18.8%
50,000 to 75,000.....	-67	-0.03%	257	19.8%	257	19.8%	20.7%	20.7%
75,000 to 100,000.....	-21	-0.01%	192	14.8%	192	14.8%	23.0%	23.0%
100,000 to 200,000.....	-14	-0.01%	226	17.4%	226	17.4%	24.2%	24.2%
200,000 and over.....	-3	(4)	257	19.8%	257	19.8%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$230</b>	<b>-0.02%</b>	<b>\$1,295</b>	<b>100.0%</b>	<b>\$1,294</b>	<b>100.0%</b>	<b>20.6%</b>	<b>20.6%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE CUSTODIAL CARE  
CREDIT CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1999**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.7%	\$9	0.7%	8.4%	8.4%
10,000 to 20,000.....	-5	-0.01%	41	3.0%	41	3.0%	9.2%	9.2%
20,000 to 30,000.....	-29	-0.03%	83	6.1%	83	6.1%	13.6%	13.6%
30,000 to 40,000.....	-57	-0.05%	120	8.8%	120	8.8%	16.9%	16.9%
40,000 to 50,000.....	-34	-0.03%	126	9.3%	126	9.3%	18.6%	18.6%
50,000 to 75,000.....	-69	-0.03%	270	19.8%	270	19.8%	20.6%	20.6%
75,000 to 100,000.....	-24	-0.01%	202	14.8%	202	14.8%	22.9%	22.9%
100,000 to 200,000.....	-16	-0.01%	240	17.6%	240	17.6%	24.2%	24.2%
200,000 and over.....	-4	(4)	271	19.9%	271	19.9%	29.9%	29.9%
<b>Total, All Taxpayers...</b>	<b>-\$238</b>	<b>-0.02%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>\$1,362</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- 
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
- (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
- (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
- (4) Less than 0.005%.

**DISTRIBUTIONAL EFFECTS OF THE CUSTODIAL CARE  
CREDIT CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 2000**

INCOME CATEGORY (1)	CHANGE IN FEDERAL TAXES (2)		FEDERAL TAXES (2) UNDER PRESENT LAW		FEDERAL TAXES (2) UNDER PROPOSAL		Effective Tax Rate (3)	
	Millions	Percent	Billions	Percent	Billions	Percent	Present Law	Proposal
							Percent	Percent
Less than \$10,000.....	\$0	0.00%	\$9	0.6%	\$9	0.6%	8.6%	8.6%
10,000 to 20,000.....	-5	-0.01%	42	2.9%	42	2.9%	9.0%	9.0%
20,000 to 30,000.....	-28	-0.03%	86	6.0%	86	6.0%	13.6%	13.6%
30,000 to 40,000.....	-54	-0.04%	125	8.7%	125	8.7%	16.8%	16.8%
40,000 to 50,000.....	-38	-0.03%	133	9.3%	133	9.3%	18.5%	18.5%
50,000 to 75,000.....	-63	-0.02%	280	19.6%	280	19.6%	20.5%	20.5%
75,000 to 100,000.....	-31	-0.01%	215	15.0%	215	15.0%	22.8%	22.8%
100,000 to 200,000.....	-16	-0.01%	255	17.8%	254	17.8%	24.1%	24.1%
200,000 and over.....	-4	(4)	289	20.2%	289	20.2%	30.0%	30.0%
<b>Total, All Taxpayers...</b>	<b>-\$239</b>	<b>-0.02%</b>	<b>\$1,434</b>	<b>100.0%</b>	<b>\$1,433</b>	<b>100.0%</b>	<b>20.5%</b>	<b>20.5%</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax-exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] worker's compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Categories are measured at 1995 levels.
  - (2) Federal taxes are equal to individual income tax, 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. Individuals who are dependents of other taxpayers and taxpayers with negative income are excluded from the analysis.
  - (3) The effective tax rate is equal to Federal taxes described in footnote (2) divided by income described in footnote (1).
  - (4) Less than 0.005%.

**DISTRIBUTION OF TAXPAYERS BY INCOME  
AND CALENDAR YEAR  
(Returns in thousands)**

<b>INCOME CATEGORY (1)</b>	<b>1995</b>	<b>1996</b>	<b>1997</b>	<b>1998</b>	<b>1999</b>	<b>2000</b>
Less than \$10,000.....	22,322	21,691	21,049	20,553	19,914	19,431
10,000 to 20,000.....	25,530	25,826	26,270	26,594	26,246	26,485
20,000 to 30,000.....	20,519	20,728	20,835	20,985	21,485	21,557
30,000 to 40,000.....	16,655	16,956	17,224	17,503	17,843	18,116
40,000 to 50,000.....	12,214	12,490	12,851	13,062	13,276	13,568
50,000 to 75,000.....	17,630	18,013	18,239	18,455	18,861	19,085
75,000 to 100,000.....	8,087	8,248	8,512	8,784	9,007	9,305
100,000 to 200,000.....	5,930	6,163	6,310	6,489	6,683	6,868
200,000 and over.....	1,633	1,648	1,690	1,727	1,779	1,827
<b>Total, All Taxpayers...</b>	<b>130,520</b>	<b>131,763</b>	<b>132,980</b>	<b>134,152</b>	<b>135,094</b>	<b>136,242</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Excludes individuals who are dependents of other taxpayers and taxpayers with income less than zero. Categories are measured at 1995 levels.

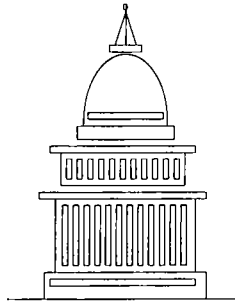
**NUMBER OF TAXPAYERS AFFECTED BY CERTAIN  
PROVISIONS CONTAINED IN THE CONTRACT WITH AMERICA  
TAX RELIEF ACT OF 1995  
Calendar Year 1996  
(Returns in thousands)**

<b>INCOME CATEGORY (1)</b>	<b>FAMILY TAX CREDIT</b>	<b>SOCIAL SECURITY TAX REPEAL</b>	<b>MARRIAGE PENALTY RELIEF</b>	<b>CUSTODIAL CARE CREDIT</b>	<b>ADOPTION CREDIT</b>
Less than \$10,000.....	22	0	0	0	(2)
10,000 to 20,000.....	2,125	1	77	46	(2)
20,000 to 30,000.....	4,146	2	716	93	(2)
30,000 to 40,000.....	4,792	35	1,857	79	(2)
40,000 to 50,000.....	4,153	386	2,230	47	(2)
50,000 to 75,000.....	7,673	1,793	3,702	78	(2)
75,000 to 100,000.....	3,759	1,136	2,944	30	(2)
100,000 to 200,000.....	2,489	1,055	2,230	17	(2)
200,000 and over.....	290	258	383	6	(2)
<b>Total, All Taxpayers...</b>	<b>29,448</b>	<b>4,667</b>	<b>14,138</b>	<b>396</b>	<b>65</b>

Source: Joint Committee on Taxation

Detail may not add to total due to rounding.

- .....
- (1) The income concept used to place tax returns into income categories is adjusted gross income (AGI) plus: [1] tax exempt interest, [2] employer contributions for health plans and life insurance, [3] employer share of FICA tax, [4] workers compensation, [5] nontaxable social security benefits, [6] insurance value of Medicare benefits, [7] alternative minimum tax preference items, and [8] excluded income of U.S. citizens living abroad. Excludes individuals who are dependents of other taxpayers and taxpayers with income less than zero. Categories are measured at 1995 levels.
- (2) Not available.

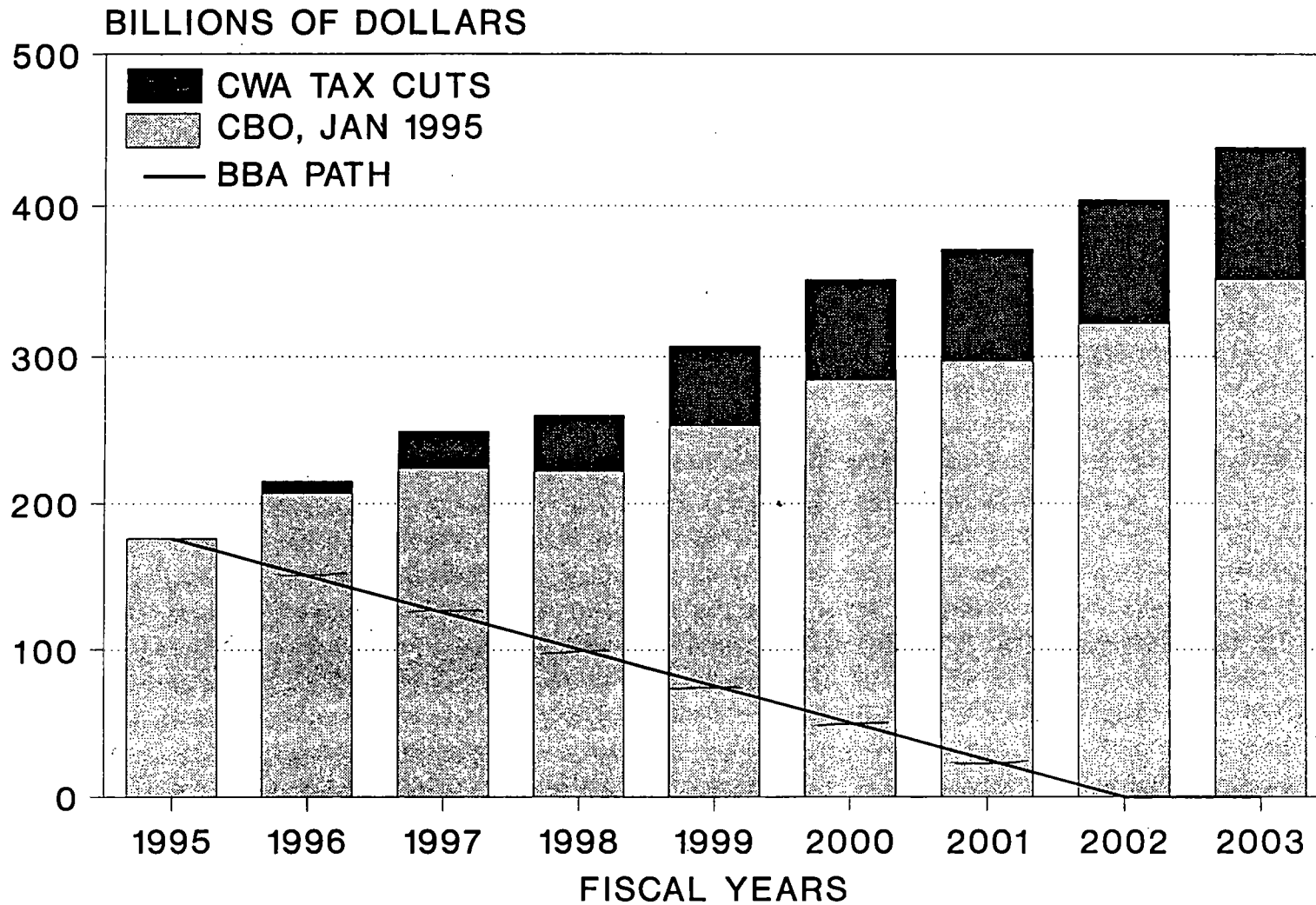


**Macroeconomic  
Aspects of the  
Republican  
Contract With America**

**February 28 - March 2, 1995  
Washington, DC**

**Laurence H. Meyer & Associates, Ltd.  
231 South Bemiston Ave. Suite 775  
St. Louis, MO 63105  
314-721-4747**

# DEFICIT PROJECTIONS & CWA TAX CUTS



SOURCE: CBO, ADM., & LHM&A

# MATH OF THE BALANCED BUDGET AMENDMENT

(Billions of Dollars, Fiscal Years)

	CBO*	TAX CUTS**	TOT	BBA***	DIFF
1996	207	8	215	153	62
1997	224	25	249	127	122
1998	222	38	260	102	158
1999	253	54	307	76	231
2000	284	67	351	51	300
2001	297	75	372	25	347
2002	<u>322</u>	<u>83</u>	<u>405</u>	<u>0</u>	<u>405</u>
CUM	1809	350	2159	534	<b>1625</b>

*as debt ⇒  
⇒ r/d  
⇒ less  
inbit  
debt number*

\* CBO, January 1995

\*\* ADM, LHM&A

\*\*\* Linear Decline Assumed

# C.W.A. TAX CUTS: THE STATIC PRICE TAG\*

(FY 1996 - 2000, Billions of Dollars)

\$500/Child Tax Credit	111
Capital Gains Tax Cut	59
Repeal '93 Soc. Sec. Tax Hike	15
Reduce Marriage Penalty	9
Lift Estate Tax Exemption	8
Dep. Care Credit for Seniors	5
Small Business Expensing	4
Tax Incentive for Adoption	1
Tax Credit for Elderly Care	1
Back Loaded IRAs	1
Expanded Home Office Deduction	1
Neutral Cost Recovery	<u>-23</u>
<b>Total</b>	<b>192</b>

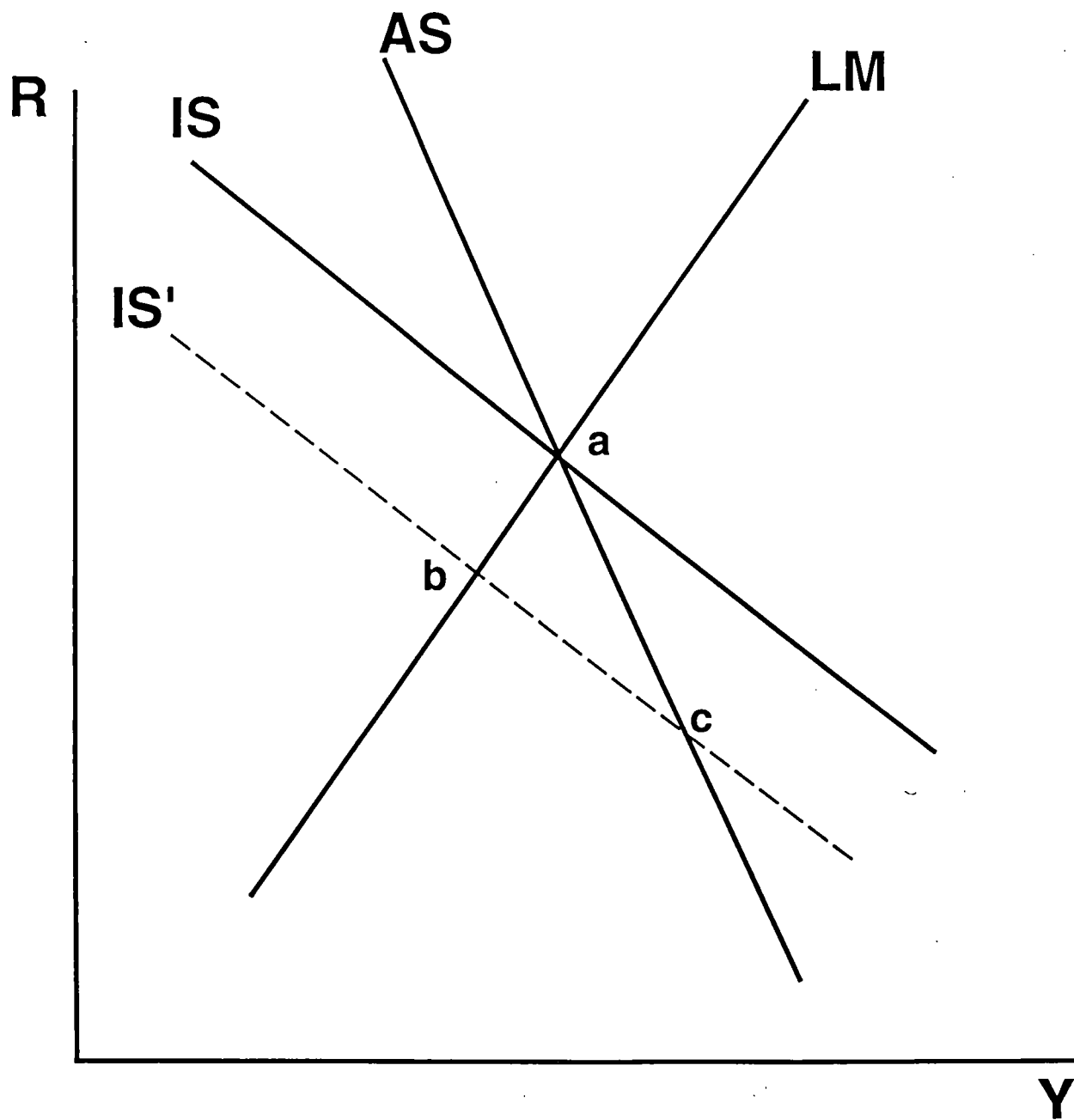
\*Source: Adm. LHM&A, Rep. House Conf.

## MACROSTATIC DEFICIT PROJECTIONS WITH & WITHOUT CWA TAX CUTS (FISCAL YEARS, BILLIONS OF DOLLARS)

	1996	1997	1998	1999	2000	2001	2002	CUM
CBO DEFICIT, JAN 1995 .....	207	224	222	253	284	297	322	1809
CWA TAX CUTS, TOTAL * .....	8	25	38	54	67	75	83	350
"Demand Side" .....	16	30	33	36	38	40	42	236
\$500/child Credit .....	12	23	25	25	26	28	29	168
Repeal 1993 SS .....	1	2	3	4	5	6	6	27
Other .....	4	5	6	6	7	7	7	41
"Supply Side" .....	-9	-5	5	19	29	35	41	115
50% Excl. Indexed Gains .....	4	8	13	16	18	18	20	97
N.C.R.S. & Expensing .....	-13	-13	-9	3	11	17	21	18
TOTAL .....	215	249	260	307	351	372	405	2159

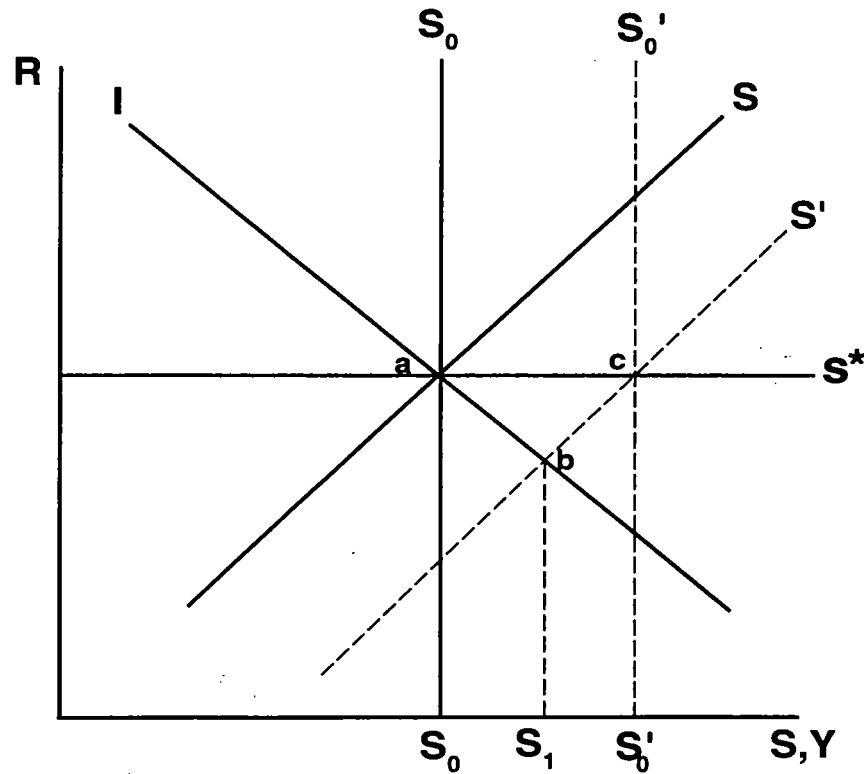
\*Source: LHM&A

# Deficit Reduction: Transitional Demand and Permanent Supply Effects

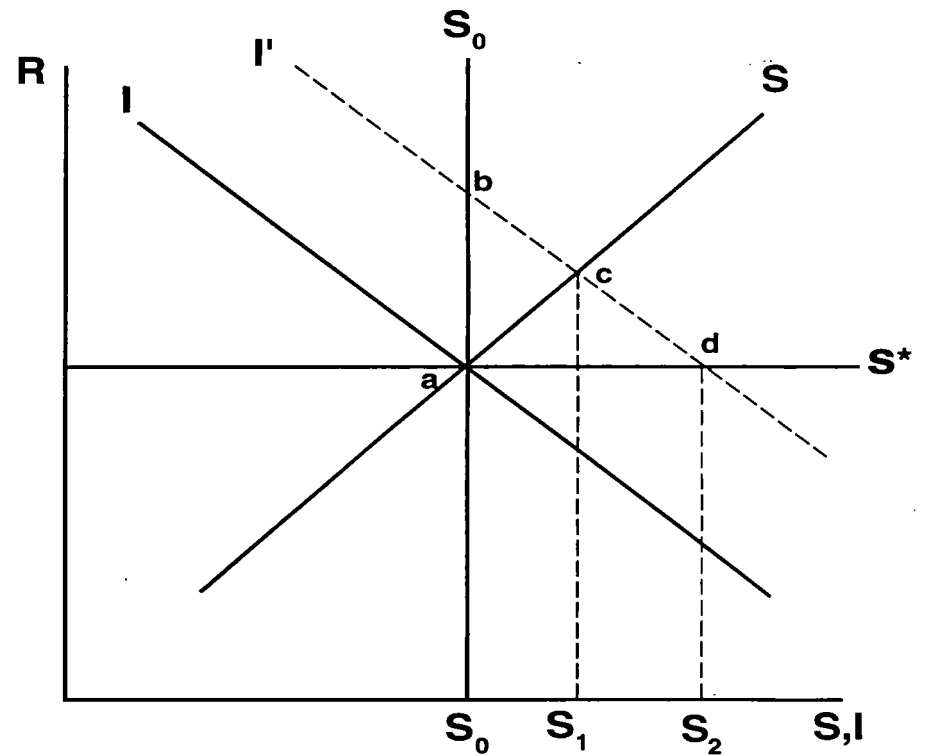


# FISCAL POLICY, SAVING, AND INVESTMENT

Deficit Reduction and the Saving Offset



Investment Incentives & the Saving Response



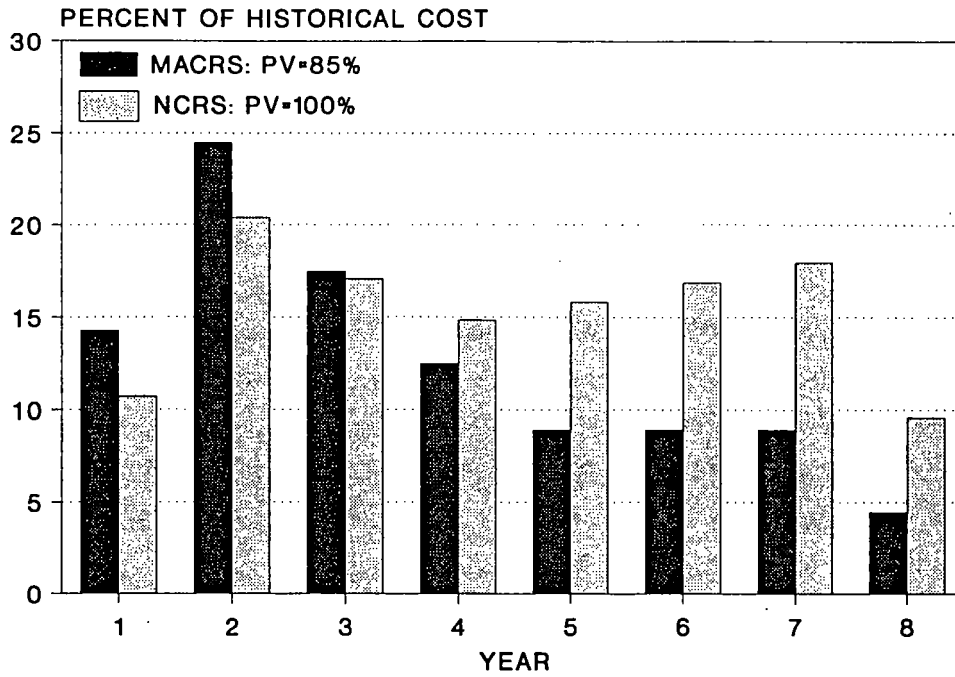
## KEY MODEL PARAMETERS

- A. NO GOVERNMENT CAPITAL
- B. UNITARY ELASTICITY OF SUBSTITUTION
- C. CAPITAL'S SHARE: 0.27
- D. PUTTY-CLAY ADJUSTMENT: SLOW
- E. ELASTICITY OF LABOR SUPPLY
  - 1. AFTER-TAX WAGES: 0.11
  - 2. TRANSFERS: 0
- F. ELASTICITY OF SAVING: SMALL
  - 1. PRIVATE: 0
  - 2. FOREIGN: +
- G. WEALTH EFFECTS IN CONSUMPTION

## SIMULATION DESIGN

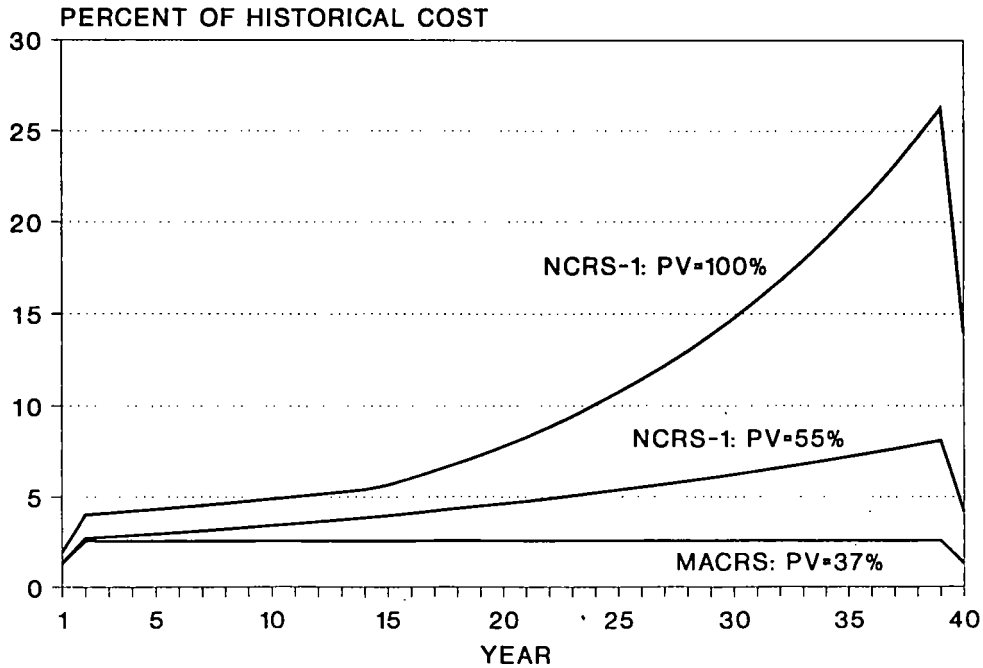
- A. BASELINE: JANUARY CBO
  
- B. PROCEDURE
  - 1. TAX CUTS / PAYGO
  
  - 2. THEN BBA
  
- C. MONETARY POLICY
  - 1. UNEM RATE IN LONG-RUN
  
  - 2. ALSO IN SHORT-RUN, IF POSSIBLE
  
- D. BOND MARKET EFFECT: NO
  
- E. NAIRU: NO CHANGE
  
- F. DEMAND SHOCK UNDER BBA

## DEPRECIATION FOR 7-YEAR PROPERTY



ASSUMES 3% INFLATION, 3.5% REAL RETURN

## DEPRECIATION FOR 39-YEAR PROPERTY

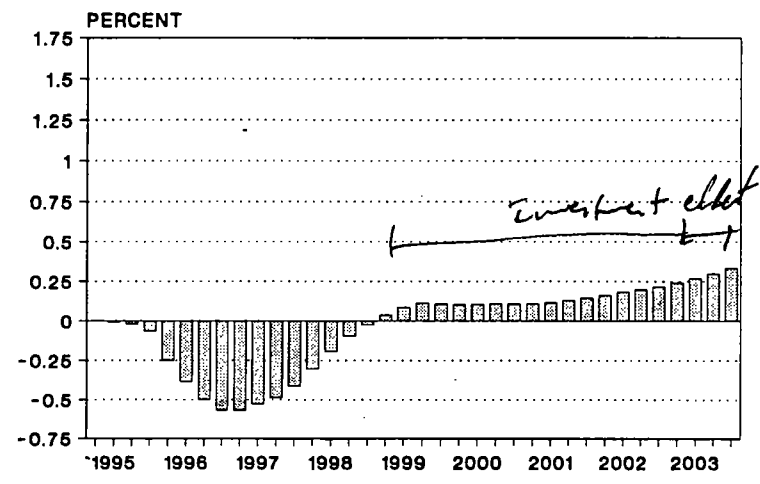


ASSUMES 3% INFLATION, 3.5% REAL RETURN

Most be getting additional savings...  
foreign savings ↑

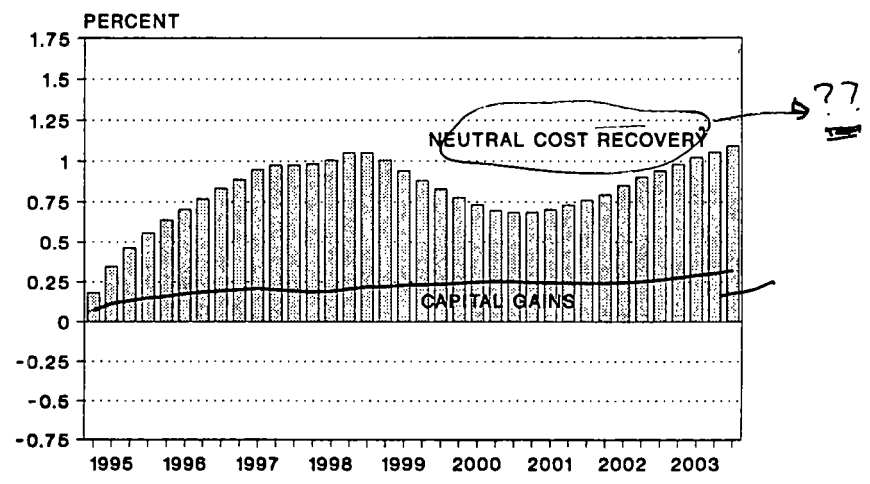
# MACRO IMPACTS OF CONTRACT WITH AMERICA

DEMAND-SIDE TAX CUTS UNDER PAY-GO  
EFFECT ON REAL GDP



SOURCE: LHM&A FEBRUARY 1995

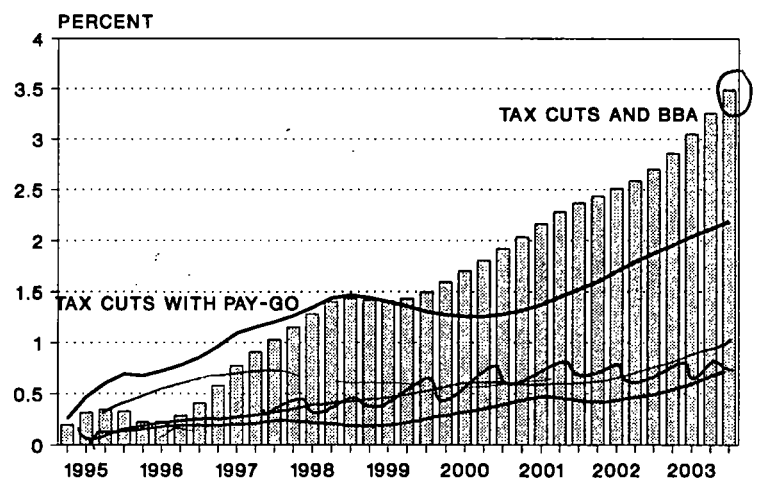
SUPPLY-SIDE TAX CUTS UNDER PAY-GO  
EFFECT ON REAL GDP



SOURCE: LHM&A FEBRUARY 1995

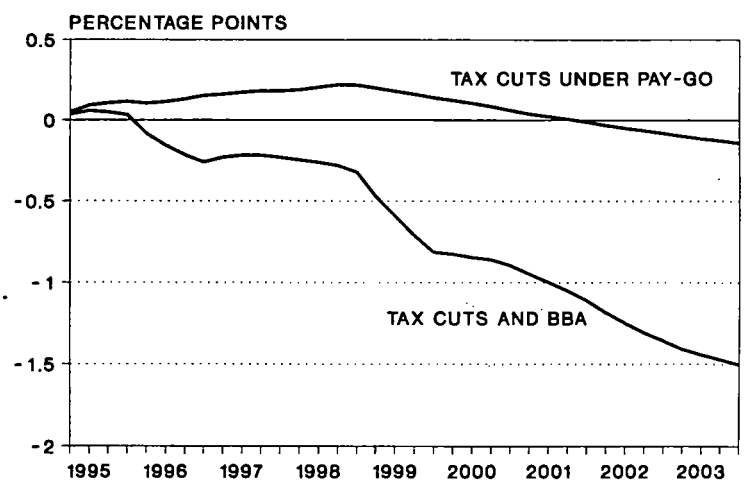
10

TAX CUTS AND BBA  
EFFECT ON REAL GDP



SOURCE: LHM&A FEBRUARY 1995

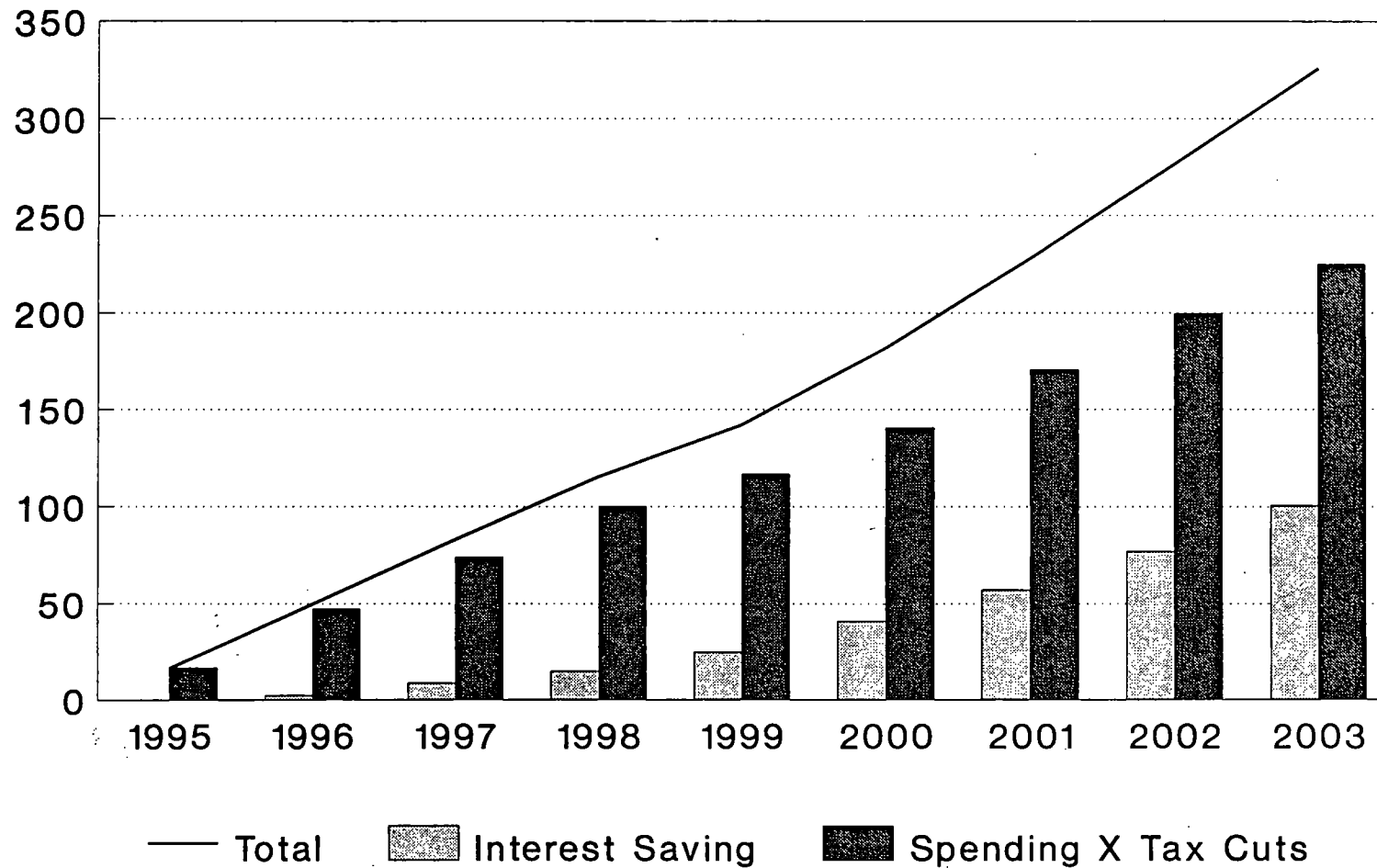
TAX CUTS AND BBA  
EFFECT ON THE GOVERNMENT BOND RATE



SOURCE: LHM&A FEBRUARY 1995

# Composition of Deficit Reduction

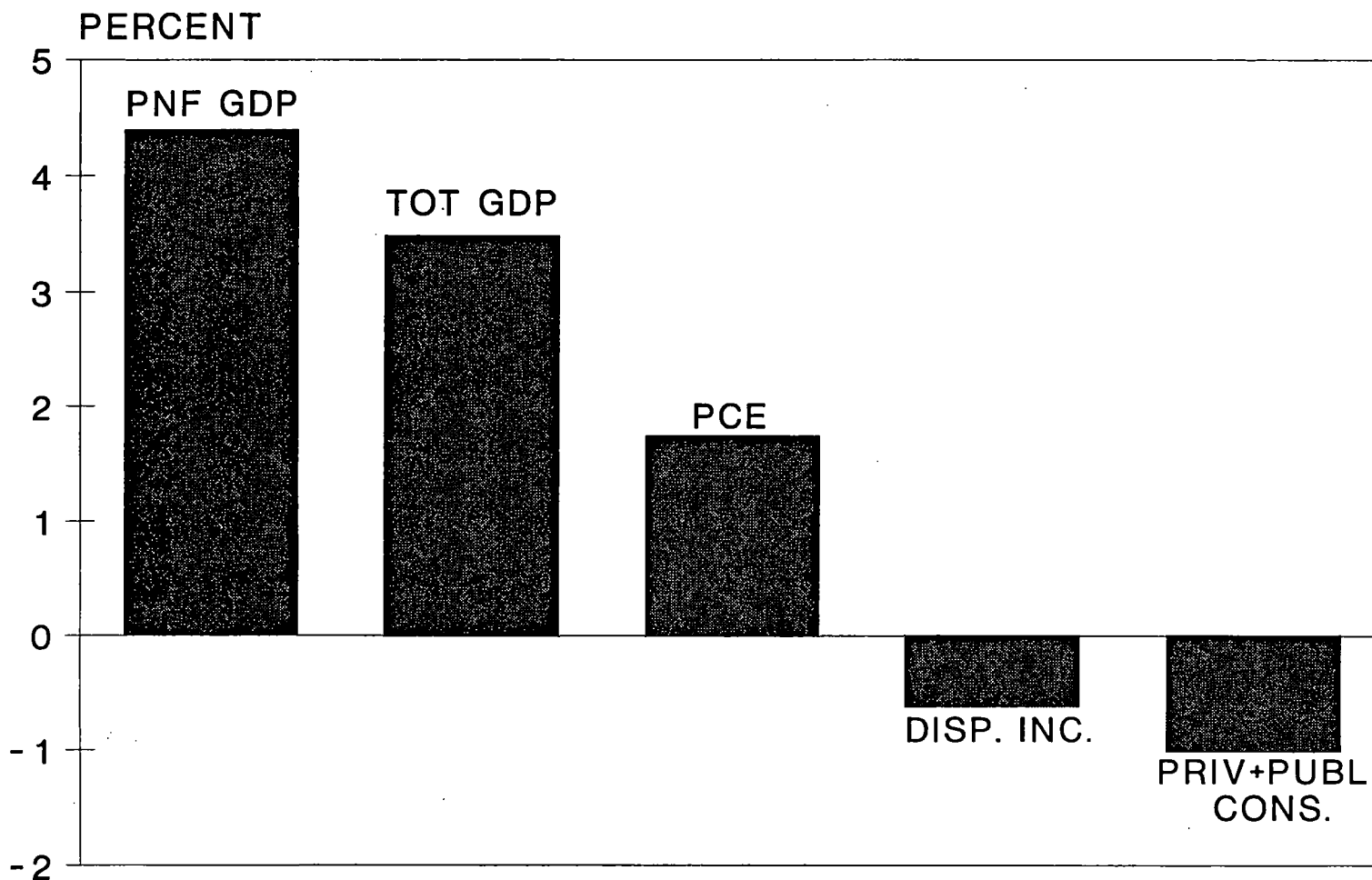
(Billions of Dollars, diff. from base)



Source: Laurence H. Meyer & Associates

*no free lunch*

# EFFECT BY 2003 OF CWA ON STANDARD OF LIVING



12

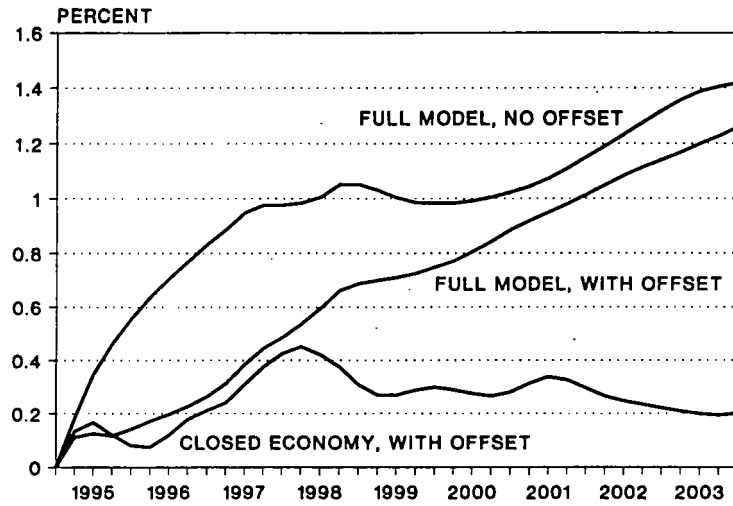
SOURCE: LHM&A FEBRUARY 1995

# THE BALANCED BUDGET AMENDMENT AS AN AUTOMATIC DE-STABILIZER?

	<u>2001</u>	<u>2002</u>	<u>2003</u>
<u>GDP (%CHG, 4/4)</u>			
BASELINE	2.8	2.5	3.3
RECESSION W/O BBA	-2.3	7.0	3.5
RECESSION W BBA	-3.5	6.1	5.1
<u>UNEM RATE (%)</u>			
BASELINE	5.8	6.1	6.2
RECESSION W/O BBA	7.5	8.6	6.9
RECESSION W BBA	7.6	9.8	8.1
<u>DEFICIT (BIL, FY)</u>			
BASELINE	8.0	0.0	-4.0
RECESSION W/O BBA	65.0	105.0	25.0
RECESSION W BBA	65.0	42.0	-41.0

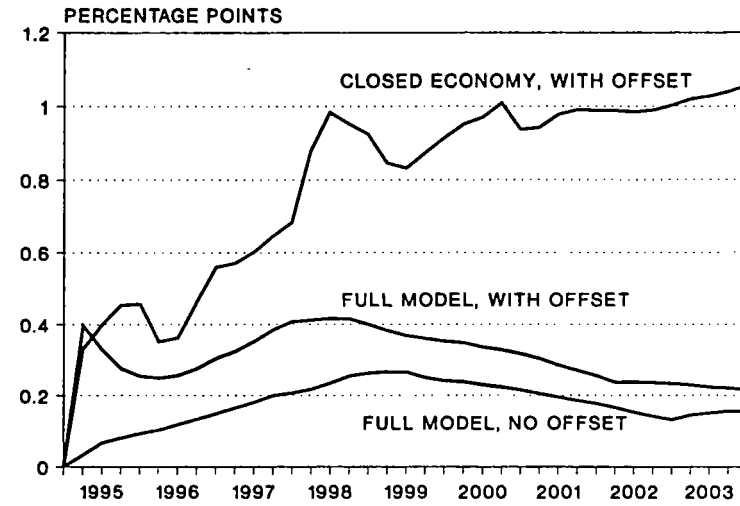
# EFFECT OF NCRS

## ON REAL GDP



SOURCE: LHM&A FEBRUARY 1995

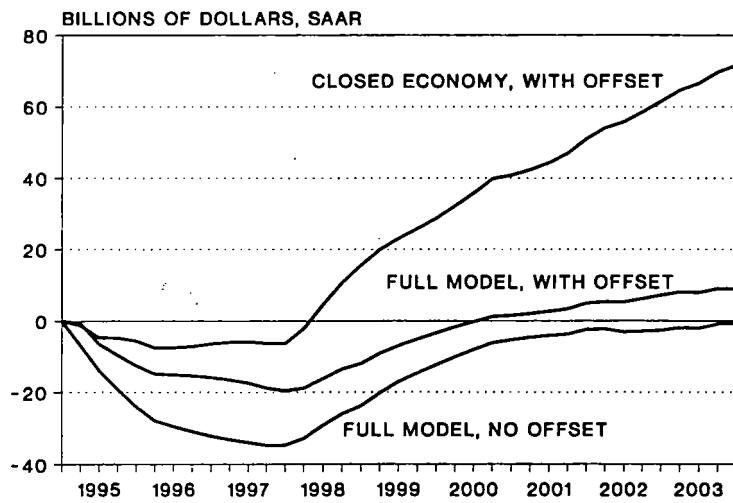
## ON GOVERNMENT BOND RATE



SOURCE: LHM&A FEBRUARY 1995

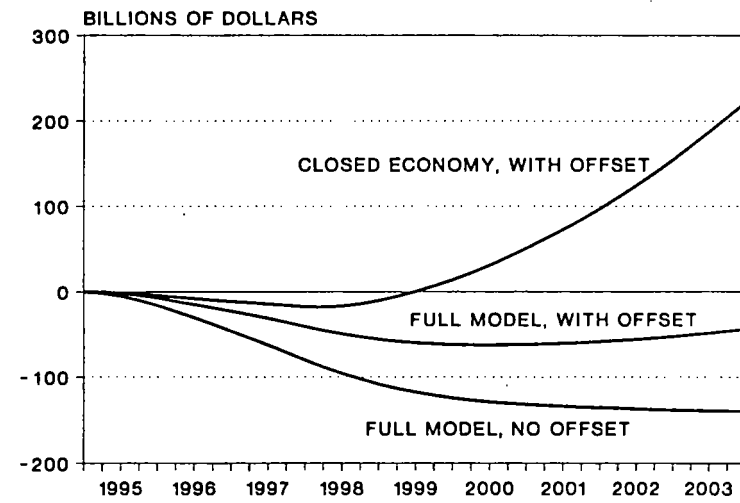
14

## ON FEDERAL DEFICIT



SOURCE: LHM&A FEBRUARY 1995

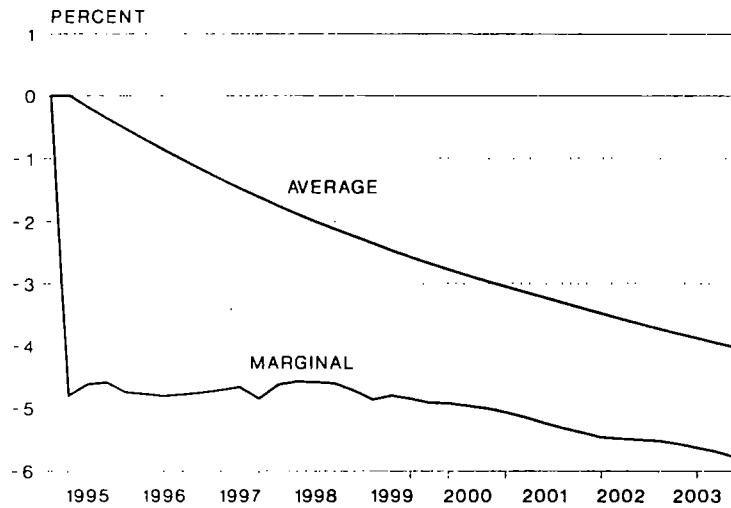
## ON FEDERAL DEBT



SOURCE: LHM&A FEBRUARY 1995

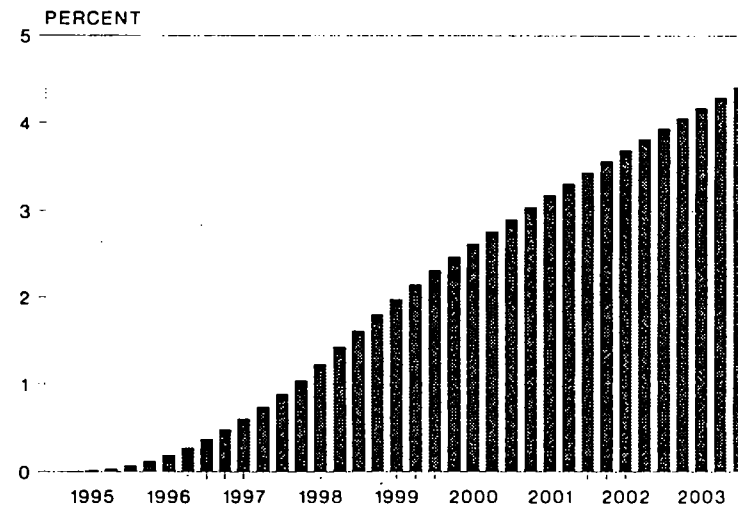
# EFFECT OF NCRS (FULL MODEL WITH OFFSET)

## ON USER COST OF EQUIPMENT



SOURCE: LHM&A FEBRUARY 1995

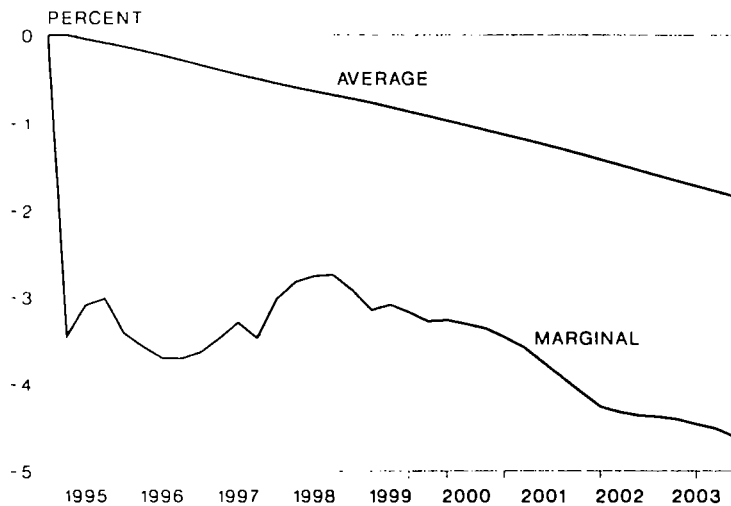
## ON REAL STOCK OF EQUIPMENT



SOURCE: LHM&A FEBRUARY 1995

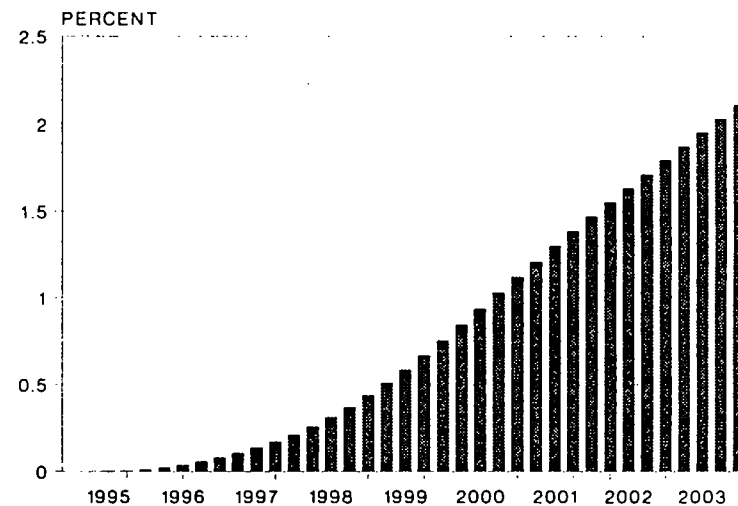
15

## ON USER COST OF STRUCTURES



SOURCE: LHM&A FEBRUARY 1995

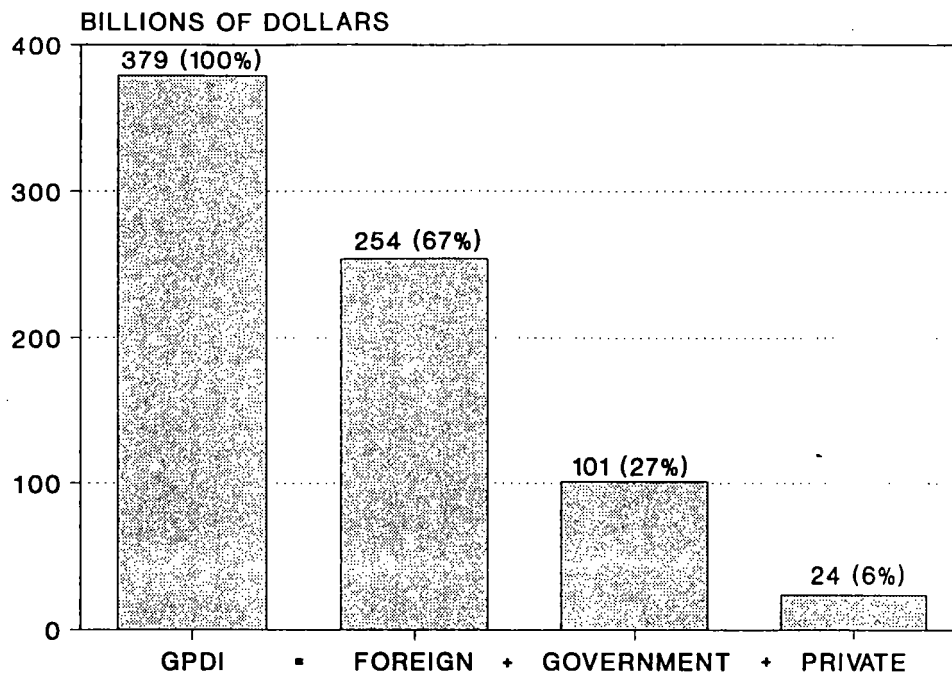
## ON REAL STOCK OF STRUCTURES



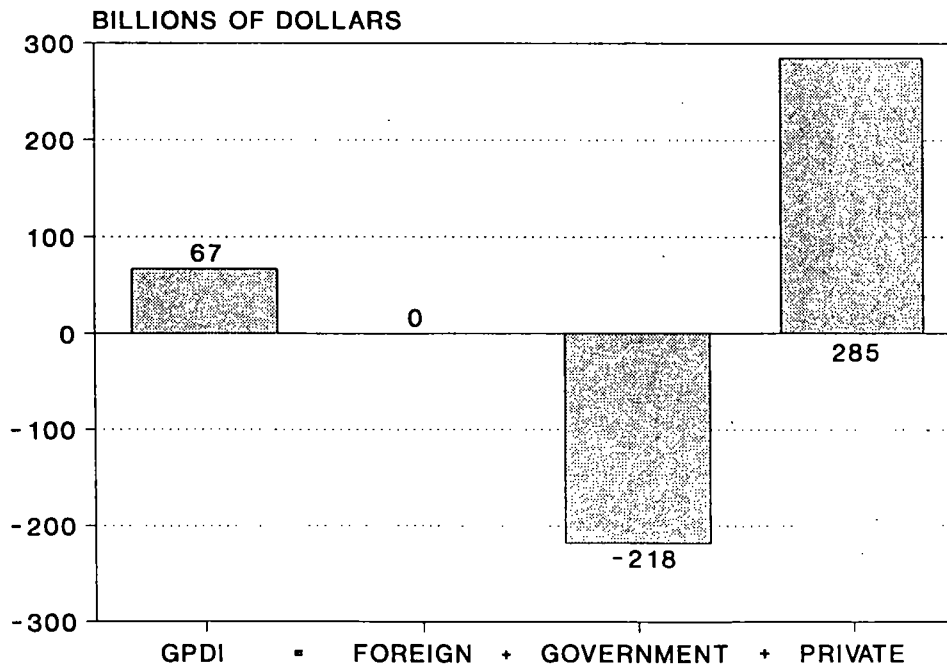
SOURCE: LHM&A FEBRUARY 1995

# NCRS: SOURCES OF FINANCING

## FULL MODEL WITH MONETARY OFFSET



## CLOSED ECONOMY WITH MONETARY OFFSET



# SPECIAL ANALYSIS

*Macroeconomic Aspects of the Republican  
Contract with America*

*Laurence H. Meyer & Associates*

*March 1995*

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## I) Summary

The Republican Party's "Contract with America" (CWA) calls for sweeping changes in the law of the land with implications for nearly every aspect of Federal domestic policy from the structure of welfare, to personal and business taxes, to law enforcement, to regulatory and legal reform, to term limits, to federal budget policy and the deficit. While many of its "planks," if put into law, would have a profound effect on the nation, we examine only those elements of the CWA with significant macroeconomic implications. These include the call for a balanced budget amendment and the business and personal tax cuts. The CWA itself does not specify the details of achieving a balanced budget, but does provide some detail regarding the business and personal tax cuts. **Thus, in this *Special Analysis* we study the macroeconomic effects of combining the specified personal and business tax cuts with sufficient spending cuts to balance the budget by 2002.**

## Methodology

These proposals were analyzed using simulations of the Washington University Macroeconometric Model (WUMM) of the US economy. The model was built and is maintained by LHM&A. A "base" simulation was prepared which incorporated "current law" assumptions regarding taxes and spending, and which had a baseline deficit roughly similar to that produced by the Congressional Budget Office (CBO). Then simulations were performed with alternative assumptions regarding taxes and spending that reflected the major components of the CWA that would be expected to have an impact on macroeconomic performance. This methodology allows us to measure both the transitional effects on aggregate demand and the permanent effects on potential output<sup>1</sup>. Of particular interest are the long-run effects on the level and composition of GDP, capital formation, labor productivity, and interest rates. We also considered the implications of a balanced budget amendment (BBA) for the effectiveness of fiscal built-in stabilizers in damping the magnitude and persistence of recessions.

## The Tax Cuts

The analysis assumed the implementation of twelve proposed tax changes. These tax changes are shown in Table 1, along with the estimates of the static<sup>2</sup> revenue loss (gain) over the first 5 years. Note that the Neutral Cost Recovery System (NCRS) would gain revenue in the first five years, but lose revenue in the next five. As a result of the revenue losses stemming from the proposed tax reductions, the spending cuts required to balance the budget by 2002 are increased. Table 2 shows the year-by-year baseline deficit, static revenue losses from the proposed tax cuts, the resulting deficits, and the deficit that would be targeted under a BBA to achieve balance by 2002. This last column indicates the magnitude of the statically-estimated spending

reductions that would have to be made to achieve a balanced budget by 2002 assuming implementation of the proposed tax cuts. As seen in Table 2, the static estimate of the revenue loss from the proposed tax changes reaches \$83 billion in the year 2002. When added to the CBO baseline deficit that year of \$322 billion, the resulting deficit, in the absence of spending reductions, would be \$405 billion. Since the budget is to be in balance by the year 2002, spending must be \$405 billion lower than would have otherwise been the case in 2002. This is shown in Figure 1. The stacked bars indicate the CBO baseline deficit plus the static revenue loss from the CWA tax cuts.

<sup>1</sup>"Potential Output" refers to the maximum sustainable level of output of goods and services that the economy can produce without experiencing rising inflation.

<sup>2</sup>"Static" revenue estimates are developed without regard to any possible macroeconomic effects of the proposed tax change and any resulting impact on the relevant tax base.

**Table 1**

**C.W.A. TAX CUTS: THE STATIC PRICE TAG\***  
(FY 1996 - 2000, Billions of Dollars)

\$500/Child Tax Credit .....	111
Capital Gains Tax Cut .....	59
Repeal '93 Soc. Sec. Tax Hike .....	15
Reduce Marriage Penalty .....	9
Lift Estate Tax Exemption .....	8
Dep. Care Credit for Seniors .....	5
Small Business Expensing .....	4
Tax Incentive for Adoption .....	1
Tax Credit for Elderly Care .....	1
Back Loaded IRAs .....	1
Expanded Home Office Deduction .....	1
Neutral Cost Recovery .....	-23
<b>Total .....</b>	<b>192</b>

\*Source: Adm., LHM&A, Rep. House Conf.

Table 2

**MATH OF THE  
BALANCED BUDGET AMENDMENT**  
(Billions of Dollars, Fiscal Years, Budget Basis)

	<b>CBO* BASELINE DEFICIT</b>	<b>+</b>	<b>STATIC REVENUE LOSS FROM PROPOSED TAX CUTS**</b>	<b>=</b>	<b>RESULTING DEFICIT</b>	<b>DEFICIT PATH "RE- QUIRED" BY BBA***</b>	<b>BUDGET SAVINGS RE- QUIRED TO BALANCE BUDGET</b>
	(1)		(2)		(3)	(4)	(5)
1996	207		8		215	153	62
1997	224		25		249	127	122
1998	222		38		260	102	158
1999	253		54		307	76	231
2000	284		67		351	51	300
2001	297		75		372	25	347
2002	<u>322</u>		<u>83</u>		<u>405</u>	<u>0</u>	<u>405</u>
<b>CUM</b>	<b>1809</b>		<b>350</b>		<b>2159</b>	<b>534</b>	<b>1625</b>

\*CBO, January Estimate

\*\* LHM&A

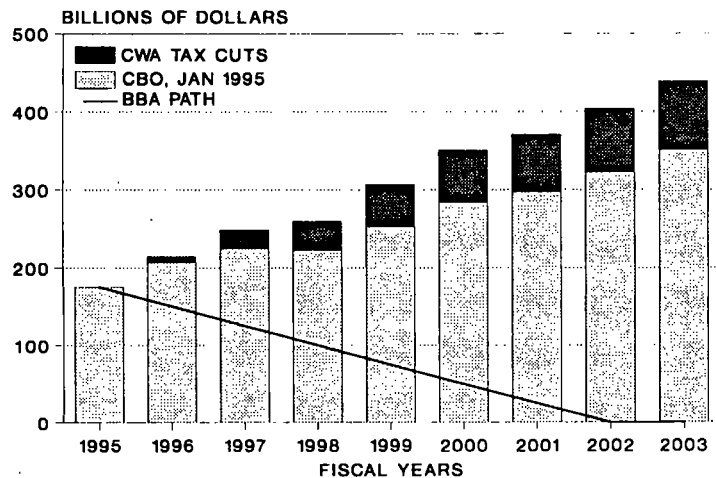
\*\*\*Linear Decline Assumed

The line shows the assumed path to a balanced budget required by a BBA. The difference between the line and the bars is the amount of budget savings required to achieve a balanced budget.

**The Spending Cuts**

The actual programmatic spending cuts required are less than shown in Figure 1 because of lower interest expense resulting from lower interest rates and a lower level of outstanding debt, as well as dynamic revenue and spending offsets. Section II below provides details on the composition of the spending reductions which are summarized in Figure 2. This chart shows, year-by-year, the composition of the required deficit reduction by programmatic spending reductions (net of the revenue loss from the tax cuts) and interest savings. The line shows how much the deficit must be reduced from the projected baseline deficit to hit the deficit target in each year. The dark bar illustrates the contribution to deficit reduction from assumed programmatic spending cuts, after subtracting the estimated revenue losses from the proposed tax cuts. The light bar shows the interest savings that result from both lower interest rates and a lower stock of outstanding federal debt. The estimate of the interest savings is generated from a simulation of the model where the tax and spending cuts have been implemented.

Figure 1  
DEFICIT PROJECTIONS



SOURCE: CBO, ADM., & LHM&A

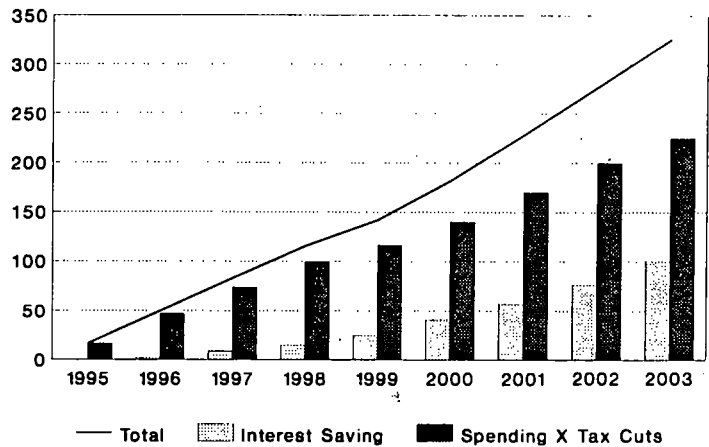
### The Economic Effects

The economic effects of the CWA can be thought of as originating from three broad classes of proposed changes: 1) demand-side tax cuts, 2) supply-side tax cuts, and 3) spending reductions required to balance the budget. The demand-side tax cuts, such as the \$500 per child tax credit, provide no significant "supply-side" incentives to supply labor, save or invest, but they do increase after-tax income and hence boost consumption and aggregate demand. The supply-side tax cuts include the proposed 50% exclusion for realized capital gains income, the prospective indexing of capital gains for tax purposes, and the proposed Neutral Cost Recovery System (NCRS). These tax changes do provide additional incentives for saving and investment, and as a result boost both aggregate demand in the near term and potential output in the long term. Finally, the spending reductions required to achieve a balanced budget by 2002 include both reductions in transfer payments to individuals, and reductions in direct purchases by the federal government. The reduction in transfers has an effect (dollar for dollar) which is similar in magnitude, but opposite in sign to demand-side tax reductions. The reductions in direct purchases of goods and services reduce aggregate demand dollar-for-dollar and thus have a slightly larger effect on aggregate demand than equivalent reductions in transfer payments.

As the above discussion implies, the demand-side and supply-side tax cuts would boost aggregate demand in the near-term. This stimulus would be offset by the programmatic spending reductions. Whether, on balance, the economy strengthens or weakens in the near-term, depends on the relative magnitude of the forces boosting and restraining demand. Under a wide range of assumptions we would expect a program of tax cuts and spending restraint that results in a gradually declining deficit to reduce aggregate demand and GDP in the near term. However, the supply-side tax incentives in the CWA are responsible for a different outcome. First, the implementation of NCRS would add to revenue initially, reducing the magnitude of the spending cuts required in the early years. Second, the supply-side incentives, while they aim to boost potential output in the long run, work by promoting investment (which is itself a component of aggregate demand) in the short and long run. Thus when the package is examined in total, it raises aggregate demand and output relative to the base simulation continuously from 1996 through 2002.

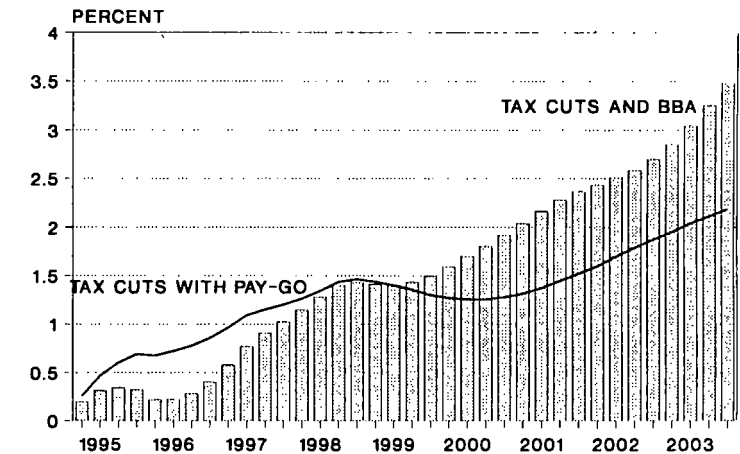
For purposes of comparison, Figure 3 shows the effects on real GDP of two different simulations: 1) a simulation in which the proposed tax cuts are "paid for" by spending reductions as would be required under the so-called "PAY-GO" rules (line), 2) a simulation that begins from (1) and adds the additional spending reductions needed to balance the budget by 2002 (bar). The difference between the line and the bar is the effect owing to the spending reductions alone. In both alternative simulations the level of real GDP is higher than in the base simulation throughout.

**Figure 2**  
**COMPOSITION OF DEFICIT REDUCTION**  
(BILLIONS OF DOLLARS, DIFF. FROM BASE)



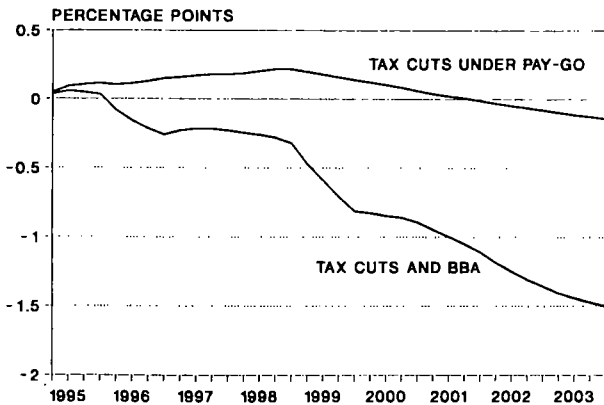
Source: LHM&A; NIPA BASIS

**Figure 3**  
**TAX CUTS AND BBA**  
**EFFECT ON REAL GDP**



SOURCE: LHM&A FEBRUARY 1995

**Figure 4**  
**TAX CUTS AND BBA**  
**EFFECT ON THE GOVERNMENT BOND RATE**



SOURCE: LHM&A FEBRUARY 1996

Because the package simultaneously raises output and raises government saving (reduces government dissaving) both absolutely and relative to GDP, the equilibrium real interest rate would be expected to fall. In fact the simulation produced a significant decline in interest rates as shown in Figure 4. The decline in interest rates reinforces the favorable response of investment and potential output in the long run. It also helps to reduce federal interest expense and thus reduces the size of the programmatic spending cuts necessary to balance the budget.

## II) Details of Tax Cuts and Spending Cuts in CWA

### The Spending Cuts

CWA incorporates a commitment to pass a balanced budget amendment. We interpret this commitment as support for *balancing the budget*, with or without the discipline afforded by a balanced budget amendment. In the absence of a specific program of spending cuts in CWA, we had to impose our own allocation of required programmatic cuts between transfer payments and discretionary purchases. Specifically, we held real medical transfers constant, reduced the COLA for other transfers one percentage point below the CPI inflation rate, and satisfied any further required spending cuts with reductions in discretionary purchases.

### The Tax Cuts

The tax cuts in CWA are detailed in Table 1, along with their 5-year static revenue costs. Here we provide a brief summary of the specific tax cuts in CWA.

The first "demand-side" tax cut in the CWA is the so-called "middle-class tax cut." It calls for a \$500 per child tax credit available for children 18 years or younger for families with incomes up to \$200,000. It is estimated that this tax cut would cost \$111 billion in lost personal tax revenue over 5 years. Note that the middle-class tax cut in CWA is not a decline in marginal personal income tax rates and therefore does not provide an incentive for additional labor input (by raising the real after-tax wage rate). Indeed, by increasing after-tax income regardless of work effort, it produces an income effect which would be expected to reduce work effort.

There is a second set of smaller demand-side tax cuts associated with a variety of other provisions, including a reduction in the marriage penalty (accomplished through a tax credit), lifting the estate tax exemption, providing a tax credit for dependent care for senior citizens, a tax incentive for adoption, and a tax credit for elderly care. We lump expensing for small business in with these other miscellaneous tax cuts.

The third most costly tax cut is the repeal of the 1993 tax increase for higher-income social security recipients. This would cost \$15 billion over 5 years. The increase in the earnings limit that would be exempt from taxation makes this a supply-side tax cut; however, any supply effects would be second order in magnitude so this tax cut was lumped in with the demand-side tax cuts for purposes of the simulations.

The CWA calls for a new back-loaded IRA ("American Dream Savings Account"). The initial investment, up to \$2000 per year for an individual and \$4000 for a married couple, would not be deductible; however, interest would accumulate tax free. Taxes would be paid on the earnings upon withdrawal. After five years, sums could be withdrawn without penalty for certain contingencies, including purchase of first owner-occupied home, educational expenses at a post-secondary institution, and medical costs. During an initial two-year period, holders of existing IRAs could switch them into the new IRAs without penalty to achieve the greater flexibility they afford. Such switching would raise tax revenue to the extent that the IRAs that were cashed out were the result of tax-free

contributions. In addition, because the new IRAs are back-loaded (initial contributions are made with after-tax dollars), their revenue cost is very small initially, though it of course builds over time.

CWA calls for a halving of the statutory capital gains tax rate (via introducing a 50% exclusion for capital gains) and then indexing the capital gains with respect to future price increases. This is projected to cost \$59 billion over 5 years, though there is considerable uncertainty about the initial revenue effects, as the lowering of the tax rate would sharply reduce the lock-in effect and might therefore result in a large volume of realizations which initially raise tax revenue.

The most dramatic tax change in CWA is the Neutral Cost Recovery System (NCRS). NCRS is a new set of rules for calculating depreciation for tax purposes. Firms could elect to continue the current system or switch to NCRS.

The current system allows equipment to be depreciated over 8 years, using the double declining balance method. Under NCRS, a 150 percent declining balance method is substituted, but the amount of the asset remaining to be depreciated is raised each year by the inflation rate (indexation) and by a real interest rate (assumed to be 3.5%). This procedure insures that the present value of depreciation allowances will be equal to the *replacement* cost of the equipment. Under the present system, the present value of depreciation allowances equals only 85% of the *original* cost of the equipment. Note that, compared to the present tax code, the depreciation allowances are smaller under CWA during the first three years, although the present value over the 8-year period is higher.

The same system was initially proposed for business structures (plant and multi-family housing units). The program for structures was subsequently revised to limit the change to adding indexation to the current 39-year straight line depreciation employed for structures. It is this revised treatment that we assume in this study.

A few comments need to be made about NCRS. First, it is not "neutral," in the sense of eliminating distortions to economic decisions from the tax code. In fact, NCRS may increase distortions because it would result in very different tax treatment of equipment, depending, for example, on whether it was debt or equity financed, and increases the difference between the tax treatment of equipment and structures. For example, allowing full non-indexed interest deductions while indexing depreciation would result in a *negative tax rate* on debt-financed equipment investments under NCRS. Second, many firms might not elect NCRS if given the option. Some report that they would not want to suffer lower depreciation for the first three years, implying that they have such high discount rates that the present value of depreciation is actually lower for NCRS. Many firms believe NCRS is, in fact, too generous and would either be removed or offset by some other tax increase, perhaps an increase in the corporate tax rate, a combination many would view as less preferable than the current tax system. In the analysis below, we assume that all firms elect NCRS.

### **CWA and Deficit Accounting**

The difficulty of the task and the potential size of the benefits of deficit reduction depend on the size of the deficit to be eliminated. In this study, we use the Congressional Budget Office's January 1995 baseline for the unified budget deficit as our point of departure, the path of the deficit in the absence of implementation of Contract with America. The baseline deficits through 2002 are reported in column 1 of Table 2 and are illustrated by the light portion of the bars in Figure 1. Note that the deficit begins near \$200 billion in fiscal 1996 and rises to \$322 billion in 2002. The baseline deficits cumulate to \$1.8 trillion over this period.

The next step is to add to the baseline deficit the static revenue effects of the tax cuts specified in Contract with America. The annual static revenue effects are detailed in column 2 of Table 2 and are depicted by the dark additions to the bars in Figure 1. The 5-year static cost of the tax cuts in CWA is \$192 billion. Note that neutral cost recovery is projected to *raise* \$23 billion over this period and hence lowers the 5-year cost, even though it would be a significant static revenue loser over the longer term. The cumulative cost of the tax cuts reported in Table 1 over the 7 years is \$350 billion, raising the cumulative deficit over the 7-year period to \$2.159 trillion.

Next we allow for a gradual decline in the deficit during the transition to a balanced budget, illustrated by the straight line beginning at the deficit in fiscal 1995 and declining to zero in 2002. The path of the deficit along this transition is reported in column 4 of Table 2. The cumulative amount of deficit reduction is the difference between the

cumulative deficit augmented by the tax cuts (column 3) and the deficit path associated with the transition to deficit reduction (column 4) and equals \$1.625 trillion (column 5).

Table 2 and Figure 1 are based on a linear path to a balanced budget. In the simulation analysis, we used a path in which the decline in the deficit was slower at first and steeper later in the period. This path resulted in smaller cumulative deficit reduction than what is reported in Table 2.

### Sources of Deficit Reduction

Although the deficit has to be reduced cumulatively by \$1.6 trillion to balance the budget by 2002, the cumulative *programmatic spending cuts* required to balance the budget by 2002 are much smaller than the \$1.6 trillion. First, CWA would raise the level of income in the long run and therefore would raise various tax bases and generate dynamic revenue gains. Second, deficit reduction, by lowering interest rates and by lowering the outstanding debt, lowers federal interest payments. Every dollar of programmatic cuts is thus rewarded by some additional "painless" decline in spending via lower interest payments and painless increase in revenue resulting from higher tax bases.

The required \$1.6 trillion in cumulative deficit reduction, including the static tax cuts, is accomplished in our simulation via about \$800 billion in programmatic spending cuts, \$300 billion in reduced interest payments on the debt, and \$500 billion in dynamic increases in tax revenue. The sources of deficit reduction in our simulation are depicted in Figure 2.

## III) The Economics of the CWA

### The Economics of the Tax Cuts in CWA

Broadly speaking, tax cuts can be characterized as either demand-side or supply-side cuts. Supply-side tax cuts are those that directly affect relative prices that influence decisions to work, save, or invest. They include cuts in marginal tax rates as well as investment and saving incentives. Demand-side tax cuts do not alter the relative prices which affect decisions to work, save or invest and have their exclusive short-run effect via aggregate demand. They do have long-run supply effects as well, but these are adverse, reflecting the shift of resources toward consumption and, via higher interest rates, away from investment. In Table 3 we show the static revenue losses by year associated with the demand-side and supply-side tax cuts.

In CWA, the two supply-side tax changes that potentially have the greatest effects are the cut in the tax rate on capital gains (via both indexing and a halving in the statutory rate) and NCRS. Other tax changes in CWA which

	1996	1997	1998	1999	2000	2001	2002	CUM
<b>CWA TAX CUTS, TOTAL *</b>	8	25	38	54	67	75	83	350
"Demand Side"	16	30	33	36	38	40	42	236
\$500/child Credit	12	23	25	25	26	28	29	168
Repeal 1993 SS	1	2	3	4	5	6	6	27
Other	4	5	6	6	7	7	7	41
"Supply Side"	-9	-5	5	19	29	35	41	115
50% Excl. Indexed Gains	4	8	13	16	18	18	20	97
N.C.R.S. & Expensing	-13	-13	-9	3	11	17	21	18

\*Source: LHM&A, Summary parts may not equal totals due to rounding

may also have immediate supply-side effects are the enhancement of saving incentives via the introduction of a new back-loaded IRA, the partial repeal of the marriage penalty, the increase in the income threshold for social security recipients, and welfare reform. Based on our research, we believe that targeted saving incentives do not have a significant effect on the private saving rate. The tax cut associated with the new IRA is therefore grouped with the demand-side tax cuts. We view the effect of the repeal of the marriage penalty and increased earnings threshold for social security recipients as having only second-order effects on labor supply. Note that the tax saving projected for partial repeal of the marriage penalty is only about 10% of the estimated cost of fully removing this penalty and would yield maximum benefits of \$145 per family that qualified. The supply-side effects of such a small change should be nil. In the absence of a specific program for welfare reform and given the uncertainties about what the effects might be on labor supply, we do not make any attempt to model the macro effects of welfare reform, other than those related to lowering government spending.

The supply-side tax cuts in CWA differ in a couple of important respects from the demand-side tax cuts in the program. First, although the demand-side and the supply-side tax cuts in CWA have an immediate positive impact on aggregate demand, supply-side tax cuts in CWA have more "bang for the buck" initially on aggregate demand than the demand-side tax cuts — i.e., they generate stimulus with less revenue loss initially. This turns out to be critical to the simulation results we report below. Second, while demand-side tax cuts ultimately undermine aggregate supply in the long run, supply-side tax cuts enhance aggregate supply in the long run.

### **The Role of Supply-side Tax Cuts in CWA**

An important motivation for the budget and tax changes in CWA is the view that the current budget and tax system distorts economic decisions in a way that lowers saving and investment. Given the low level of net national saving in the U.S., both relative to earlier periods and relative to other industrial countries, eliminating these distortions may reasonably be viewed as an important priority for public policy.

These distortions include high government deficits which directly lower national saving; inflation non-neutralities in the tax code (such as the taxation of nominal capital gains and the use of original cost depreciation) which bias the system to lower saving and investment; and the taxation of (indeed the double taxation of) capital income which also lowers saving and hence investment.

The correction of the distortion introduced via high government deficits is readily achieved via deficit reduction, though the benefits of deficit reduction depend importantly on how the deficit is reduced. Specifically, the benefits can be significantly compromised if deficit reduction is accomplished by raising marginal tax rates or by removing existing incentives for work, saving, or investment or by lowering government-sponsored investment in either human capital (e.g., education and training programs) or in the public infrastructure.

The distortions associated with inflation non-neutralities in the tax code can be eliminated via indexation, although partial indexation (as proposed in CWA) can end up increasing rather than reducing distortions in the tax code.

Similarly, lowering the taxation of capital income can, in general, introduce additional distortions if, for example, the changes result in wider discrepancies than exist now in the tax treatment of different investments and/or encourage tax shelters that yield high investment with low productivity (e.g., buildings without tenants). In addition, lowering the distortions can be done in ways that are relatively inexpensive (by targeting incentives to new investment) or in ways that are relatively expensive (by conferring substantial windfalls on holdings of existing assets). Those familiar with the details of the tax provisions in CWA will recognize in this discussion some serious deficiencies in that program, accounting for the lack of enthusiasm for these provisions even among those who share the objective of reducing distortions to saving and investment.

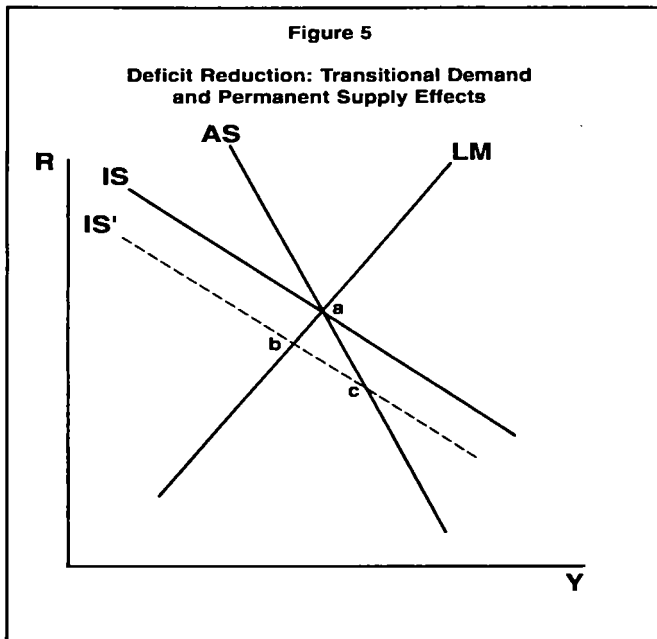
In addition, combining spending cuts and tax incentives for saving and investment with a middle-class tax cut which encourages consumption reduces the overall beneficial effect of the program on saving, investment, productivity growth, and output.

Finally, there is growing interest in tax reform, with a focus on both flattening the tax code and shifting toward

taxation of consumption rather than income. Given this interest, it would be imprudent to make dramatic changes in the tax code that might interfere with or have to be reversed by subsequent tax reform legislation.

### Key Properties of WUMM

Before proceeding to a discussion of the simulation results, it is useful to review the key theoretical and empirically determined properties of WUMM which will have an important bearing on the results. The key properties of WUMM relevant to the study of CWA is that it allows for both transitional demand and permanent supply effects of fiscal policy innovations. These properties are illustrated in Figure 5. This is a standard IS-LM diagram, augmented to include a long-run aggregate supply curve (AS). The AS curve is downward sloping because a decline in the interest rate raises the desired capital stock and hence increases productive capacity and the level of output in the long run. The AS curve shifts rightward when supply-side tax incentives are increased. For example, a cut in marginal personal tax rates raises the labor force, shifting the AS curve rightward. Cuts in capital gains tax rates or accelerations in depreciation lower the cost of capital to firms, raise the desired capital stock, and therefore also shift the AS curve rightward.

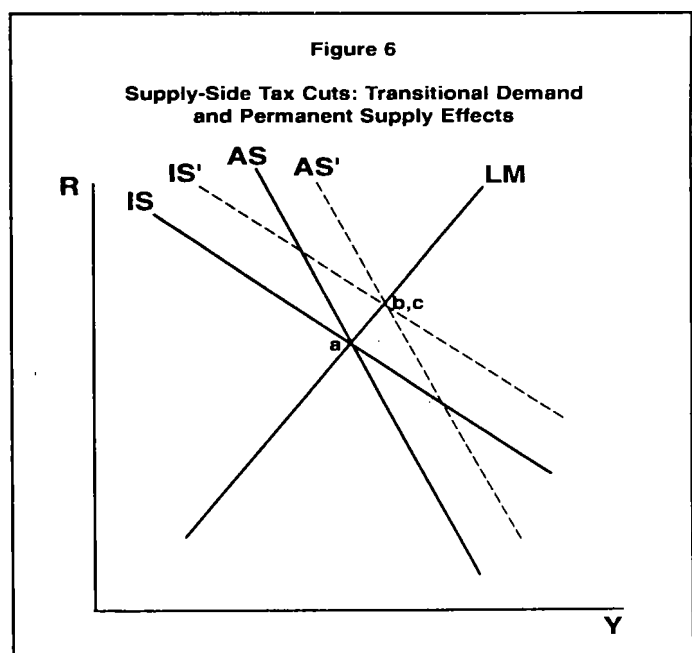


In the short run, output is demand determined in WUMM. Deficit reduction reduces aggregate demand and, unless offset by monetary easing, results in a transitional period of lower output. This is illustrated by the effect of a leftward shift in the IS curve, associated with a decline in government purchases. In the short run, the economy moves from point a to point b in Figure 5, to a lower level of both output and interest rates.

Output is supply determined in the long run in WUMM. In the long run, either via price flexibility or stabilization policy, the economy ultimately moves back to full employment. For example, beginning at point a, there is excess supply in the labor and output markets, prices are falling, and the real money supply is rising. The LM curve, as a result, shifts rightward until a new equilibrium is achieved at point c. Because interest rates are lower, investment is higher. Higher investment means a higher capital stock and hence a higher level of productive capacity and output. Therefore, in the long run, the lower level of government spend-

ing will lower interest rates, stimulate investment, and raise both labor productivity and the level of output. The middle-class tax cut would have just the opposite effect of the cut in government spending. In the short-run it would stimulate aggregate demand, but in the long run it would lower aggregate supply.

The supply-side tax cuts — specifically, the cut in capital gains tax rate and introduction of neutral cost recovery — directly raise investment demand. These policies both raise aggregate demand in the short run and aggregate supply in the long run. They can be illustrated as rightward shifts in both the IS and AS curves. In the short run, via higher aggregate demand, the level of demand and output will be higher, depicted by the movement from point a to point b in Figure 6. In the long run, as the economy returns to full equilibrium, these policies will move the economy to point c where the level of output is still higher than with unchanged policies.



The quantitative results depend importantly on key parameter estimates in the model, including (1) the response of saving to changes in the interest rate, (2) the elasticity of substitution between labor and capital which determines the response of capital formation to both changes in interest rates via deficit reduction and to changes in the cost of capital associated with supply-side tax changes, (3) the share of capital in national income which determines the effect of increases in capital formation on labor productivity, (4) the response of labor supply to changes in the after-tax real wage rate which determines the response of labor supply to increases in the real wage rate associated with higher labor productivity, and (5) the dynamics of the investment process (in our model, putty-clay technology) which affects the speed of adjustment of capital formation to both interest rates and supply-side tax changes. Table 4 summarizes some of the key parameter values in WUMM.

We noted earlier that WUMM estimates a very small positive interest responsiveness of private saving to interest rates. The model does, however, allow for a more significant effect of interest rates on foreign saving. An increase in interest rates in the U.S. increases the attractiveness of dollar-denominated assets relative to foreign-currency denominated assets, raising the demand for dollars, and resulting in an increase in the exchange rate. This, in turn, makes U.S. goods less attractive in world markets, lowering net exports. The resulting increase in the current account deficit is offset by an increase in the capital account surplus; i.e., by net capital inflows into the U.S. which can be used to finance a higher level of domestic investment.

WUMM incorporates a Cobb-Douglas production function in which the elasticity of substitution between capital and labor is unity. This implies that a decline in the cost of capital (e.g., resulting from lower real interest rates and/or enhanced investment incentives) yields an equiproportional increase in the demand for capital. This result, which is the outcome of our econometric estimation and not an assumption, means that investment is highly sensitive in the long run to changes in both interest rates and investment incentives in WUMM.

The equation for labor productivity is one of the key equations in our model for determining the long-run response to policy changes. This equation allows capital deepening to raise the level of labor productivity, allowing for an increase in output for any given level of labor input. The response of labor productivity depends directly on the share of capital in national income. The greater this share, the greater the response of labor productivity to a change in the cost of capital. In our estimation, the coefficient on the cost of capital implies that the capital share of national income is 27%, precisely the share we estimate from NIPA data.

Capital in WUMM is putty-clay, meaning that the capital labor ratio can be modified before the capital is purchased, but is fixed for that capital thereafter until, of course, it wears out and can be replaced. This is also the outcome of our estimation process. It implies a slow speed of adjustment of investment to both interest rate changes and changes in investment incentives. As a result, the capital stock has not fully adjusted to either the interest rate declines or the investment incentives during the simulation horizon in this study.

The elasticity of labor supply with respect to the after-tax real wage is relevant even though the program does not lower the marginal tax rate on labor income. By raising the capital stock, the program will raise labor productivity. This in turn will increase the real wage and induce an increase in labor supply, reinforcing the positive supply-side effect of a higher capital stock.

The combination of supply-side tax cuts and deficit reduction dominate the qualitative features of the effects. In the short run, the positive demand-side effects of the tax cuts more than offset the contractionary effect of the spending

**Table 4**

**KEY PARAMETERS IN WUMM**

<b>LABOR SUPPLY ELASTICITY</b>	0.11
<b>SAVING ELASTICITY</b>	
PRIVATE DOMESTIC	0*
FOREIGN	+
<b>DEMAND FOR CAPITAL</b>	
ELASTICITY OF SUBSTITUTION	1.0
SHARE OF CAPITAL IN NAT. INC.	0.27
ADJUSTMENT SPEED	SLOW

\*No direct effect of after-tax real interest rates on the saving rate. Small effects via interest-induced wealth effect, low propensity to consume out of asset income, and via business saving.

cuts. In the long run, the positive supply-side effects of the capital gains and neutral cost recovery reinforce the positive long-run supply effects of deficit reduction.

### The Response of Saving to Investment Incentives and Deficit Deduction

One of the key determinants of the gains from deficit reduction and investment incentives is the response of saving to after-tax interest rates. Some studies that yield significantly higher effects from investment incentives achieve this result via extreme assumptions about the response of saving to such incentives.

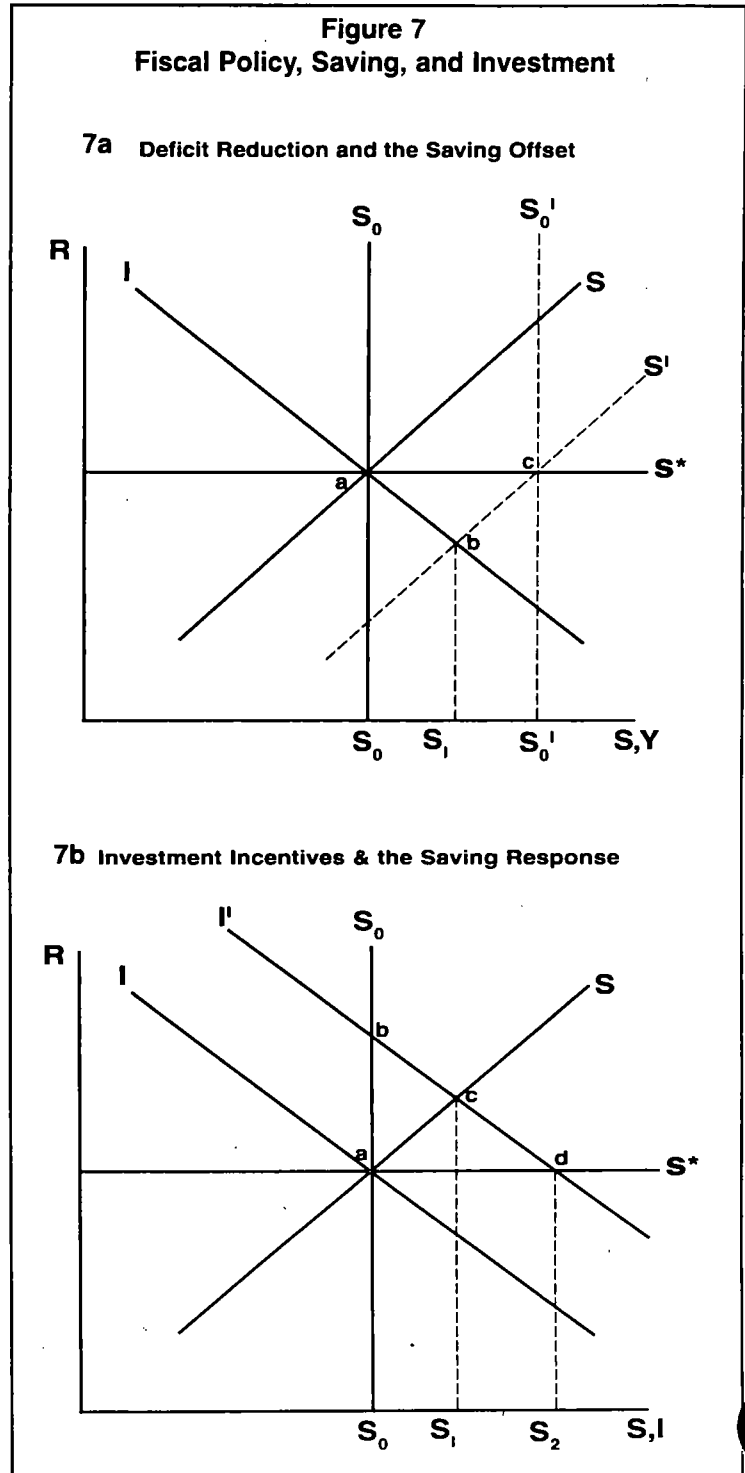
How the effectiveness of investment incentives depends on the specification of the saving function is illustrated in Figure 7a. Investment incentives directly raise the demand for investment, depicted as a rightward shift of the investment function. This drives up interest rates. If saving responds positively to interest rates, then investment incentives will raise saving and investment and thereby raise productive capacity and GDP. This is illustrated as the movement along the upward sloping saving curve in Figure 7a, from point a to point b.

If saving is unresponsive to interest rates, however, investment incentives will simply raise interest rates until they are high enough to offset the benefits of the investment incentive and leave saving and investment unchanged. This is depicted by the shift of the investment curve along the vertical saving curve, from point a to point c.

If saving is infinitely elastic with respect to the interest rate, on the other hand, investment incentives will have their largest possible impact. The shift in the investment curve will be along the horizontal saving curve; the interest rate in this case is not bid up by the higher investment and the effect on investment is greater than in the case of the upward sloping saving curve.

How the assumption about the response of saving to interest rates affects the economy's response to a cut in the deficit is depicted in Figure 7b. A cut in government spending which lowers the deficit results in a decline in government dissaving and thus an increase in national saving. In this case, however, any positive response of U.S. private or foreign saving to interest rate changes damps the effect of deficit reduction on overall saving, investment and hence productive capacity. As the interest rate declines, the decline in private (or foreign saving) partially offsets the initial increase in national saving and undermines the increase in investment.

The best possible case for deficit reduction is therefore a vertical saving curve, implying no interest-induced decline in private or foreign saving. This



would result in an increase in investment from point a to point c in Figure 7b. The worst possible case would be an infinitely elastic saving curve. In this case, private and/or foreign saving fall dollar for dollar with any decline in government dissaving. The interest rate therefore remains unchanged and there is no increase in investment.

Theory suggests an ambiguous effect of after-tax interest rates in the personal saving rate. The empirical evidence is somewhat mixed, but dominated by results that suggest a negligible effect. In WUMM, personal saving does not respond to changes in the after-tax rate of return. However, changes in wealth induced by changes in interest rates do introduce some limited interest sensitivity to private saving in WUMM. However, foreign saving does appear to be interest sensitive and this is confirmed by the estimates in WUMM. Thus investment incentives crowd out net exports, raise foreign capital inflows, and thereby allow additional investment. It also follows that deficit reduction, by lowering U.S. interest rates relative to those abroad, reduces net capital inflows, partially offsetting the effect on overall saving of a cut in the government deficit. Thus the simulations with WUMM are best understood in terms of the positively sloped saving curve, with most of the interest responsiveness coming from foreign rather than private domestic saving.

#### **IV) The Policy Simulations**

We structured the simulations so as to allow us to analyze the separate effects of several of the major CWA components. First we constructed a policy simulation which included only the demand-side tax cuts described above with offsetting spending cuts (as required under PAYGO). We then constructed two additional simulations of the capital gains tax cuts and NCRS. Next we combined the demand-side and supply-side tax cuts (with PAYGO). Finally we constructed a simulation which included the additional spending cuts required to balance the budget by 2002, consistent with the Balanced Budget Amendment proposed in CWA.

We did not simulate the tax cuts alone, but only in combination with offsetting spending cuts. This procedure reflects the restrictions imposed via the PAYGO provision in the current budget law, introduced in the October 1990 budget accord. PAYGO requires that any tax cut be offset either by tax increases or by cuts in entitlement spending. It is possible that PAYGO might be broadened to allow the offsetting spending cuts to come from discretionary spending as well as entitlements. We assumed this more flexible treatment in our simulation.

The effects of CWA on output and interest rates in the short and long run are shown in Figure 8a through 8d. The effects of the demand-side tax cuts are shown in Figure 8a. Each of the two key supply-side tax cuts are shown separately in Figure 8b. In Figures 8c and 8d we show the results of the simulation combining both the demand and supply-side tax cuts, and the final simulation which included all tax cuts and the spending cuts required to achieve a balanced budget in 2002.

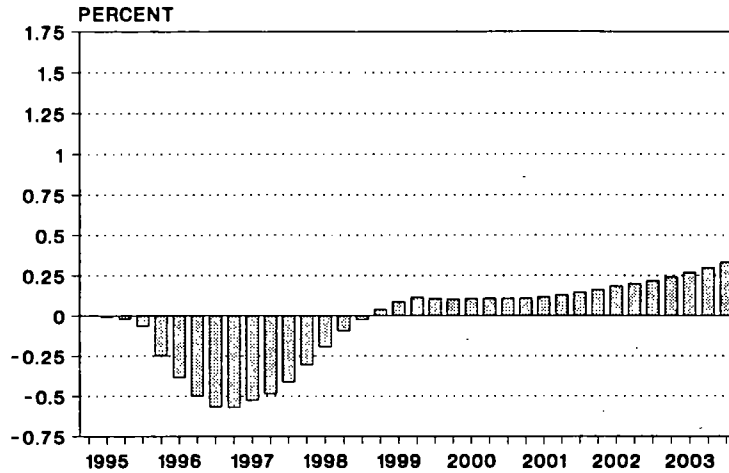
##### **The Demand-side Tax Cuts**

Offsetting the demand-side tax cuts with spending cuts gives us the textbook balanced budget fiscal policy change and we see the expected result. Equal reductions in taxes and spending (which statically don't affect the budget deficit) are contractionary because the cut in spending has a larger negative demand effect than the positive demand effect of the cut in taxes. This net contractionary effect on demand results in an initial decline in GDP, shown in Figure 8a. However, the initial adverse demand effect turns positive in the long run, shown by the transition to higher levels of GDP later in the simulation period. As output declines initially, interest rates fall, and investment increases. When the economy returns to full employment, the composition of output has changed, away from private and/or public consumption and toward private investment, raising the capital stock and hence labor productivity and productive capacity.

##### **The Supply-side Tax Cuts**

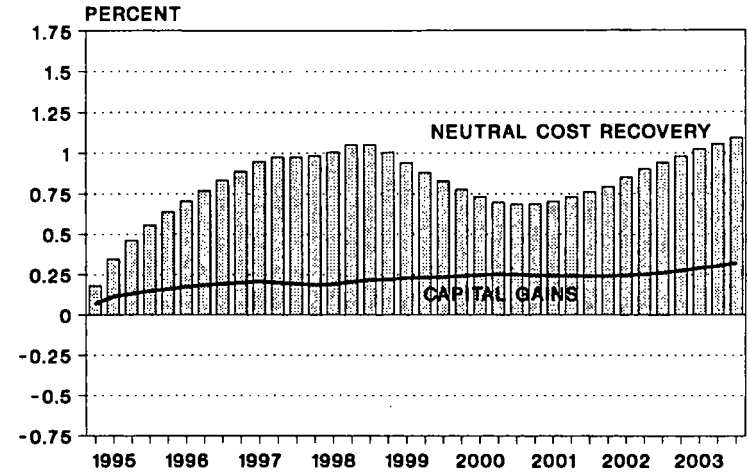
The case of the supply-side tax cuts is different. Because the supply-side tax cuts have such a large "bang for the buck," they yield a positive demand stimulus even when offset by spending cuts. In effect, they have a negative balanced budget multiplier; equal reductions in spending and taxes yield an increase in demand. As a result, aggregate demand and hence output rises even in the short run. The supply-side incentive effects in the capital gains tax cut and in neutral cost recovery also result in positive long-run supply effects. Thus output rises in both the short and the long run. The output effect for the capital gains tax cut is relatively modest, 0.25% of GDP after 7 years. Neutral cost recovery has a larger long-run effect, about a 1% increase in GDP after 7 years.

**Figure 8a**  
**DEMAND-SIDE TAX CUTS UNDER PAY-GO**  
**EFFECT ON REAL GDP**



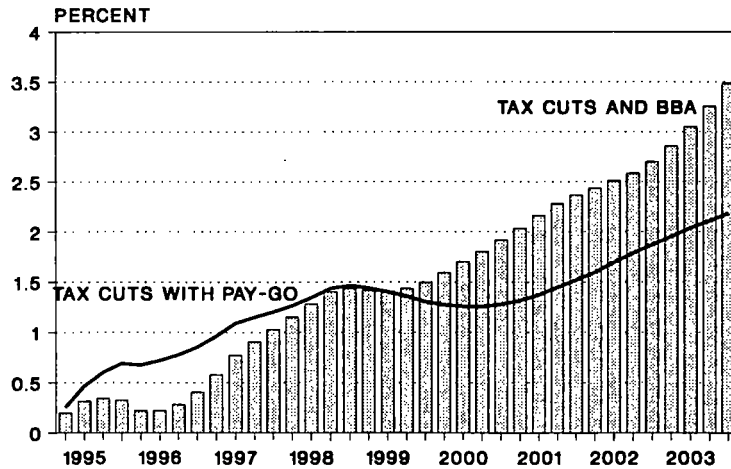
SOURCE: LHM&A FEBRUARY 1995

**Figure 8b**  
**SUPPLY-SIDE TAX CUTS UNDER PAY-GO**  
**EFFECT ON REAL GDP**



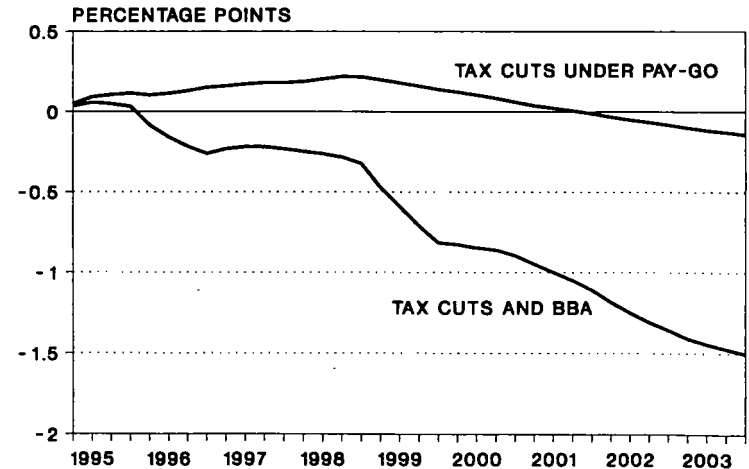
SOURCE: LHM&A FEBRUARY 1995

**Figure 8c**  
**TAX CUTS AND BBA**  
**EFFECT ON REAL GDP**



SOURCE: LHM&A FEBRUARY 1995

**Figure 8d**  
**TAX CUTS AND BBA**  
**EFFECT ON THE GOVERNMENT BOND RATE**



SOURCE: LHM&A FEBRUARY 1995

### **The Combined Tax Cuts**

In Figure 8c we show the impact on real GDP from the combination of all the tax cuts together. The result is a very small net short-run stimulus and a sizeable long-run increase in supply. GDP is almost 2% higher after 7 years as a result of the combined demand-side and supply-side tax cuts offset by spending cuts. Figure 8d shows the effect on the 30-year government bond yield.

### **The Tax Cuts and a Balanced Budget**

Finally we add on the additional spending cuts required to balance the budget. These have a short-run contractionary effect and a long-run positive effect on aggregate supply. The total long-run supply effects are the sum of the benefits of the supply-side tax cuts and spending reduction, partially offset by the effect of the demand side tax cuts. The total effect is to raise the level of GDP 3.5% after 10 years, implying an increment to GDP growth of 0.35 percentage point per year during this period. The effects of the level of output are not yet complete, but the increment to the growth rate is still only transitory and ultimately will fade away, leaving a permanent effect only on the level of GDP. The higher growth rate reflects the benefits of a change in the composition of output away from public consumption and toward private investment. Figure 8d shows a decline in long-term interest rates of 150 basis points that we estimate would result from the program.

### **Monetary Policy and the Bond Market Effect**

One concern about deficit reduction is always the size and persistence of any transitional adverse effect on aggregate demand and hence GDP growth and employment. To the extent that there were adverse transitional demand effects, we would have to consider the potential for changes in monetary policy designed to offset the contractionary demand effects of the fiscal policy.

But the powerful stimulative effects of the supply-side tax cuts allow the total program to be a net stimulus to demand, even in the short run. Hence monetary policy is not needed to counter a contractionary demand impact. Because the net demand stimulus is initially so small, we assume no Fed response in the short run. However, over the longer run, the persistent declines in government spending do impose a contractionary effect on demand and we assume that monetary policy becomes more stimulative, allowing interest rates to decline and thereby maintain the economy on the path for the unemployment rate it would have achieved in the absence of CWA. Of course, although the unemployment rate is the same in the base and policy simulations, the level of output is higher because CWA raises labor productivity.

The implementation, or indeed the credible announcement, of significant spending reduction has the potential for a so-called bond-market effect. This refers to the immediate decline in long-term interest rates which could dampen (and some have even argued reverse) any transitional decline in aggregate demand associated with deficit reduction. If long-term bond rates fell initially because of a bond market effect, aggravating the stimulus already present in this program, the Fed would have to move to raise short-term rates to offset the demand stimulus from the fiscal policy changes.

### **The Effect of a Balanced Budget Amendment on Built-in Fiscal Stabilizers**

There is one additional effect of the BBA that deserves careful scrutiny, that is the *effect of neutralizing or at least muting the action of built-in fiscal stabilizers*. The BBA, of course, makes no distinction between *cyclical and structural deficits*. Increases in cyclical deficits during recessions, however, are unambiguously good and preventing these deficits would seriously raise the cyclical instability of the economy. True, the BBA requirements could be waived for cyclical reasons, but a minority could stand in the way of doing so. This problem could also be avoided by running a sufficiently large surplus in good times, so that recessions only reduced this surplus rather than producing deficits. But this would force an average level of government spending below the level that would otherwise be considered optimal.

Simulation experiments suggest that the increase in the depth of recessions under a balanced budget amendment could be significant. A comparison of the effects of a recession on the deficit, output, and the unemployment rate, with and without strict adherence to a balanced budget amendment are reported in Table 5.

We start out with an average post-war recession, involving a decline in GDP for a year and a cumulative decline in output of 2.3%. In this case the deficit rises \$65 billion in the first year. The BBA does not require any corrective

action within the current fiscal year, but would require tax increases and/or spending cuts which, based on static scoring, would balance the budget in the following fiscal year. In the absence of a BBA, the cyclical deficit would rise to \$104 billion in the second year. We therefore lower government spending by \$104 billion in the second fiscal year, which begins in the last quarter of the first year of the simulation. The result is to significantly deepen and to prolong the recession. The cumulative decline in GDP is now 3.5%, instead of 2.3%, and the peak unemployment rate rises to 9.8% from 8.6%.

### V) Caveats and Trade-offs

Returning to the positive long-run effects on output, it should be noted that these will be over-stated to the extent that spending cuts undermine programs that enhance training, education, public infrastructure, and government-funded basic research.

In addition, to the extent the tax provisions introduce new distortions into the tax code and encourage tax shelters, the higher capital stock may have lower productivity than estimated in our simulation results.

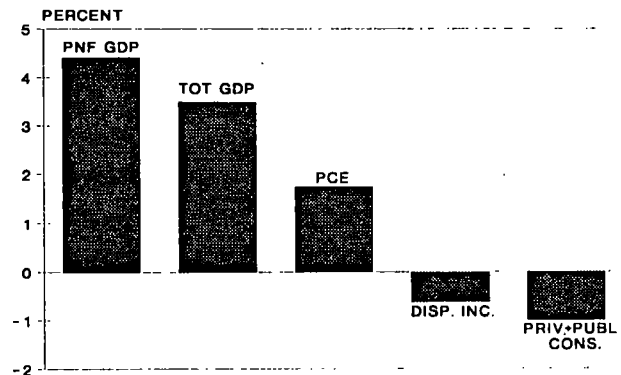
Finally, we should not neglect the trade-offs forced by this program: more output tomorrow is obtained at the sacrifice of lower public consumption now and in the future. If the value of this public consumption is low, then this is likely to be a very desirable trade-off. But the value of the programs cut should not be ignored in a welfare analysis of CWA. The nature of the trade off is illustrated in Figure 9. Note that the sum of public and private consumption is lower for the first 10 years of the program. This, of course, is the investment phase where higher output is concentrated in investment. But it is important to understand that the benefits of deficit reduction on living standards, measured in terms of private and public consumption, will not be evident for a considerable period of time. This may well dampen the political support for the effort.

**Table 5**

**THE BALANCED BUDGET AMENDMENT AS AN AUTOMATIC DE-STABILIZER?**

	<u>2001</u>	<u>2002</u>	<u>2003</u>
<b>GDP (%CHG, 4/4)</b>			
BASELINE	2.8	2.5	3.3
RECESSION W/O BBA	-2.3	7.0	3.5
RECESSION W BBA	-3.5	6.1	5.1
<b>UNEMPLOYMENT RATE (%)</b>			
BASELINE	5.8	6.1	6.2
RECESSION W/O BBA	7.5	8.6	6.9
RECESSION W BBA	7.6	9.8	8.1
<b>DEFICIT (BIL, FY)</b>			
BASELINE	8.0	0.0	-4.0
RECESSION W/O BBA	65.0	105.0	25.0
RECESSION W BBA	65.0	42.0	-41.0

**Figure 9**  
**EFFECT BY 2003 OF CWA**  
**ON STANDARD OF LIVING**



SOURCE: LHM&A FEBRUARY 1995



# CENTER ON BUDGET AND POLICY PRIORITIES

9:30

## THE CONTRACT WITH AMERICA PROPOSAL: ASSESSING THE LONG-TERM IMPACT

By Iris Lav, Cindy Mann, and Pauline Abernathy

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### Overview

On September 27, 1994, a number of federal tax and budget changes were proposed in a *Contract with America* released by a group including House Republican Members of Congress. Among other proposals, the Contract calls for changes that would reduce revenues by approximately \$190 billion over the next five years.<sup>1</sup> The revenue proposals include a new tax credit for children, a new type of Individual Retirement Account, reductions in the rate of taxation of capital gains income for individuals and corporations, a reduction in taxes for businesses that invest in buildings, machinery, and equipment, and a reduction in the extent to which Social Security income is taxable for higher-income taxpayers. In addition, the proposal calls for a constitutional amendment requiring a balanced budget by the year 2002.

There are four key issues with respect to the long-term impact of the Contract.

- **The revenue loss under the plan would rise dramatically after five years.** The plan is presented as losing \$190 billion in revenue over the next five years, itself a substantial amount. But the IRA, capital gains, and business depreciation provisions are designed so they lose smaller amounts or even *raise* revenue over the next five years — and then lose much larger amounts of revenue after the five-year budget period ends.
  - The IRA proposal is said to raise \$5 billion over the next five years, but past analyses show it could eventually lose \$50 billion over subsequent five-year periods.
  - The Contract puts the cost of the capital gains proposal at \$56 billion over its first five years. But the Joint Committee on Taxation has estimated that the cost in the second 5-year period after enactment could exceed \$160 billion.

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<sup>1</sup> House Budget Committee minority staff cost estimates for the Contract with America, September 22, 1994. No further estimates were released with the Contract. The staff estimate showed a total cost of \$147.9 billion, which is comprised of \$192.9 billion in net revenue reductions offset by \$45 billion in spending cuts in welfare, nutrition, and crime bill programs.

- The Contract lists the depreciation proposal as raising \$20 billion over the first five years. Past analysis of similar proposals suggests that the cost in subsequent five-year periods could reach \$58 billion.

Just these three proposals in the Contract, which are said to have a net cost of \$31 billion in their first five years, could have a combined cost in subsequent five-year periods of more than \$260 billion. Thus, the overall eventual revenue loss from the Contract for subsequent five-year periods greatly exceeds \$190 billion. If the costs of all other tax provisions in the Contract remained constant at \$159 billion, the cost in subsequent five-year periods could exceed \$400 billion.

- **The revenue proposals would likely cause either a worsening of the deficit or unusually large reductions in major benefit programs.** The deficit has been halved as a share of the Gross Domestic Product since 1992, but the proposals in the Contract would put further progress in question. Over the next five years, large potential budget savings would have to be devoted to paying for tax cuts rather than continuing to make progress on deficit reduction. After five years, when the revenue losses would escalate, much larger cuts would be needed to keep the deficit from growing. If, in addition, the budget had to be balanced — as the Contract calls for — cuts of unusual depth would likely have to be made in many big-ticket items in the budget. This suggests that major benefit programs such as Medicare, Medicaid, veterans programs, and Social Security could be subject to substantial reductions.
- **Future Medicare benefit reductions or tax increases would be required.** The Medicare hospital insurance trust fund is out of long-term balance. The Medicare actuaries project that without changes to reduce Medicare costs or increase the revenues flowing into the trust fund, the Medicare hospital insurance trust fund will be insolvent by 2001. Yet the Contract would lower the taxes that are now deposited in the Medicare trust fund. The Contract proposes to cut the taxes of higher-income Social Security beneficiaries through lowering the proportion of their Social Security benefits that are subject to taxation; under a 1993 law, these taxes go to the Medicare trust fund. By withdrawing these revenues from the trust

Since 1984, the Center on Budget and Policy Priorities has been analyzing the effects of various tax and budget proposals on low-income families. Over the years, the Center has issued more than 20 analyses of tax plans, including analyses of Clinton, Bush, Gingrich, Bentsen, and Rostenkowski tax proposals. This analysis of the "Contract with America" is the latest in this series.

fund, the Contract would push Medicare further out of balance and require larger Medicare reductions or tax increases to avert insolvency.

- **High-income households would be the only clear winners.** Several of the major revenue proposals — including the changes in IRAs, capital gains taxation, and the taxation of Social Security income — would primarily benefit those at higher income levels.
  - Past analyses indicate, for example, that about 95 percent of the benefits from the IRA proposal would accrue to the top fifth of the population.
  - Almost half of the benefits from the capital gains provisions would go to the wealthiest one percent of the population.
  - The reduction in the proportion of Social Security benefits that are subject to taxation would give a tax break to the top 13 percent of beneficiaries.

Middle income families would benefit significantly from the \$500 per child tax credit, but whether middle income families are better off in the long-run would depend on how the costs of the various tax cuts are financed. This is especially true in years after the five-year budget period ends, when the costs of the tax cuts primarily benefitting upper-income households and corporations begin to mushroom. If financing the tax cuts required sharp cuts in programs from which middle income families derive substantial benefits, significant numbers of middle income families might find their disposable incomes reduced as a result of the offsetting actions.

Low-income households are the clear losers. They would gain little from the tax proposals but bear most of the burden from the budget cuts identified in the Contract. They would likely also be affected by other cuts that would ultimately have to be made.

### **Escalating Costs in Future Years**

In issuing the Contract, its authors have provided estimates of its costs over the next five years. This is the period for which the impact of tax bills are considered under the provisions of the Budget Enforcement Act of 1990. Under that Act, any revenue reduction must be offset within the five-year period through increases in other taxes or reductions in entitlement spending, so that no increase in the deficit occurs.

Thus, even when a tax proposal such as the Contract does not include the offsetting measures to achieve deficit neutrality, it is traditional to assess the costs over the five-year period.

In years after the five-year estimation period, however, the costs of the Contract's proposed new Individual Retirement Accounts, capital gains taxation, and business depreciation allowances are likely to increase rapidly. Each of these proposals has been structured to have costs that are relatively small in the initial years after enactment but increase over time.

### **"American Dream Savings Accounts"**

The Contract would establish "American Dream Savings Accounts (ADSAs)," which are a new version of current Individual Retirement Accounts (IRAs). Prior to the Tax Reform Act of 1986, taxpayers at all income levels could deposit up to \$2,000 a year in an IRA and deduct that amount in figuring their income taxes. The Tax Reform Act eliminated the IRA deduction for single individuals with incomes exceeding \$35,000, and for married couples with incomes above \$50,000, who are covered by an employer-sponsored pension plan. This and other tax advantages for people at higher income levels were eliminated in the 1986 act in exchange for sharply lower income tax rates. Nevertheless, more than 70 percent of taxpayers with earnings remain eligible for an up-front deduction for IRA contributions.

Simply restoring the \$2,000 IRA deduction for those who lost it in 1986 would cost between \$30 billion and \$40 billion over five years, based on past Joint Tax Committee estimates of such proposals. The Contract's ADSA proposal, however, has a number of provisions that are more generous than pre-1986 IRAs.

- Like pre-1986 IRAs, the Contract would allow taxpayers at all income levels to contribute to an ADSA. Unlike the pre-1986 law and the current law on IRAs, however, the Contract would index for inflation in future years the \$2,000 maximum permitted deposit. Thus, the maximum permitted deposit amount would grow over time.
- In addition, the Contract would allow each spouse to make a contribution up to the limit whether or not both spouses work. Under pre-1986 law and current law on IRAs, non-working spouses may make a maximum deductible contribution of only \$250.

Because the ADSA provisions allow higher tax-advantaged contributions than pre-1986 IRAs, the proposal should cost more than simply restoring universal deductibility

would cost. Yet the Contract says its IRA expansion *raises almost \$5 billion* over five years.

How can a more generous tax break raise revenue? The Contract achieves this feat through the use of several devices to shift the timing of tax payments. These devices increase revenue collections in the short term but lead to large revenue losses outside the five-year budget period.

### *Timing Devices Mask Exploding Costs*

The Contract's ADSA is a version of what is often described as a *backloaded* IRA. Under current law, eligible taxpayers may deposit funds into an IRA and deduct the contribution from their taxable income. Funds deposited in IRA accounts then accumulate interest that is tax free until the funds are withdrawn after retirement. Withdrawals of both principal and interest are taxed as ordinary income at that point. With a *backloaded* IRA, there is no up-front deduction, but all interest earned in the account would be permanently tax free. As long as taxpayers leave the funds in the account for at least a specified number of years (such as the five-year period the Contract specifies for the ADSAs), both the interest and the principal could later be withdrawn without paying tax. Thus, unlike current IRAs, the interest earned is never subject to taxation.

Ultimately, backloaded IRAs cost the federal government about the same as regular IRAs, but the timing of the revenue losses differs. Backloaded IRAs have very little cost initially because the taxpayer receives no up-front tax deduction on the amount put into the IRA. Over time, however, the costs mount. The total amount of funds in backloaded IRAs increases as the years pass, and as a result, the interest earned on a growing share of the personal savings in the United States becomes exempt from taxation. The backloading intentionally shifts the bulk of the revenue loss to a period not covered by the budget rules requiring deficit neutrality to be maintained over the next five years.

In addition to being backloaded, the Contract's ADSA proposal also has another key feature, known as a rollover provision. This provision also helps turn the proposal from a revenue-loser to a revenue-gainer over the first five years. Under the rollover option, a taxpayer who currently holds a regular IRA would be allowed — for the two years after the ADSA provisions are enacted — to withdraw funds in current IRA accounts free of penalty, pay taxes on the withdrawn funds (the tax payments would be spread over the subsequent four years), and deposit the withdrawn funds into a new, backloaded ADSA. The funds transferred to the ADSA would be tax-free in perpetuity so long as the deposit remained in the account for at least five years.

The rollover provision is expressly designed to induce taxpayers with existing IRAs to roll them over and pay tax now rather than paying tax after they retire. The taxes collected now as a result of this provision are then used to offset the revenue losses from the ADSA proposal over the next five years and to help turn the proposal from a revenue-loser to revenue-gainer during the five-year budget period. After the five-year budget period ends, however, so does the one-time infusion of revenues from the rollover provision.

Moreover, the rollover provision causes revenue collections to be substantially lower after the five-year period ends than otherwise would be the case. The rollover device does not raise any new revenue; the revenue it brings in during the next five years is revenue that would have been collected in subsequent years when IRA account-holders retired. The rollover simply shifts the timing of the revenue collection.

The rollover provision is likely to be attractive to taxpayers who hold existing IRAs, because the new ADSAs provide a vehicle for tax-advantaged savings for a variety of purposes. Under current law, funds in an IRA must remain on deposit until the taxpayer reaches age 59½. A taxpayer younger than age 59½ who withdraws funds from an IRA must pay a penalty in addition to the taxes due on the withdrawn amounts. By contrast, once funds have remained in an ADSA for five years, they may be withdrawn without penalty for a variety of qualifying purposes. The qualifying purposes include first-time home purchases; higher education expenses for the taxpayer or the taxpayer's spouse, children or grandchildren; and a variety of medical expenses, including the purchase of insurance for long-term care. Given the choice, some taxpayers will want to rollover their accounts, thereby gaining the option to use their tax-advantaged savings before retirement.

The combined effect of the backloading and rollover provisions is simultaneously to push most of the revenue losses caused by the ADSAs outside the five-year budget window, while accelerating into the five-year budget period billions of dollars in revenue collections that normally would occur later. This is what allows proponents to claim that an expensive tax cut raises almost \$5 billion during the five-year budget period.

The timing of revenue gains and losses is not accidental, nor was the concept of backloaded IRAs and the rollover device invented by the authors of the Contract. These devices were developed by both Democratic and Republican members of Congress in the early 1990s for one purpose only — to circumvent the pay-as-you-go requirements of the 1990 Budget Enforcement Act by artificially making most of the costs of the IRA expansion disappear during the five-year budget period.

Thus, the ADSA provision portrayed by the Contract authors as a revenue-raiser is actually a large revenue loser after the five-year budget period ends. Past analyses

have found the long-run annual costs of similar IRA proposals to be five times as large as their costs in their fifth year. That suggests this provision could add \$50 billion to the federal deficit over subsequent five-year periods.<sup>2</sup>

While IRA type proposals are extremely costly, there is little or no evidence that such provisions benefit the economy through increasing the rate of savings. For example, a 1991 report of the Republican staff of the House Committee on the Budget found that "most evidence suggests that savings is unresponsive to any tax incentives designed to increase it...Even the most optimistic estimates of the responsiveness of savings to taxes are too low to support the argument that such incentives significantly boost savings and growth."<sup>3</sup> Because IRAs are likely to swell the long-term budget deficit by an amount that would be greater than any likely increase in savings, another report concluded that IRAs are likely to slow long-term economic growth.<sup>4</sup> (See box on pages 12-13.) In other words, if the ballooning revenue loss of the contract ADSA proposal outside of the five-year budget period were not offset by increases in other taxes or cuts in spending, economic growth could be impeded.

### Taxation of Capital Gains

The Contract also includes proposals to cut the capital gains tax, which is the income tax paid on profits from the sale of assets such as stocks, bonds, art, and rare coins. The Contract proposals affecting the capital gains tax paid by individuals would allow investors to lower the tax paid on profits in two ways. First, taxpayers could exclude from taxation the portion of profits that is attributable to inflation. In addition, half of the inflation-adjusted profits would be excluded from taxation. The combination of these two provisions would sharply lower the effective rate at which most capital gains, or profits, are taxed. Although very high-income taxpayers pay a marginal tax rate of 39.6 percent on other types of income, these taxpayers would face a maximum rate of 19.8 percent on capital gains income — and lesser rates after adjustment for inflation. At no time since 1954, has the maximum marginal tax rate that high-income taxpayers pay on capital gains been this low. (See box on page 10.)

By combining a 50 percent exclusion with an adjustment for inflation, the Contract goes beyond the major capital gains proposals advanced over the past several

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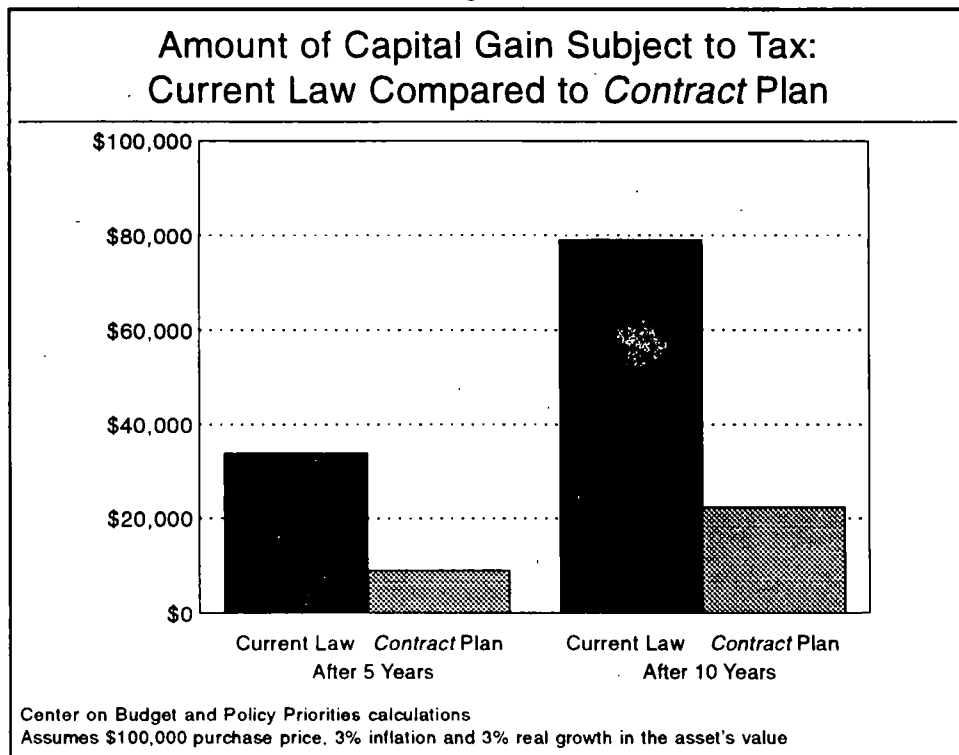
<sup>2</sup> Jane G. Gravelle, Congressional Research Service, *Statement before the Committee on the Budget, U.S. House of Representatives*, February 11, 1992.

<sup>3</sup> House Committee on the Budget, Republican Staff Report, *Tax Incentives, Growth and Deficit Reduction, Budget and Economic Analysis*, Volume I, Number 3, November 6, 1991.

<sup>4</sup> House Committee on the Budget, Republican Staff Report, *The Truth About IRAs*, Volume 1, Number 4, November 22, 1991.

years. The capital gains cuts offered by President Bush in 1991 and 1992, for example, called for exclusions that varied based on the length of time an asset was held. The maximum exclusion proposed by President Bush was 45 percent, and his proposals did *not* couple the exclusion with an adjustment for inflation. Other bills have included inflation indexing (i.e., adjusting for inflation), but not coupled with an across-the-board exclusion as high as 50 percent. Through the combination of an exclusion and inflation indexing, the Contract would allow a substantial majority of capital gains income to escape any taxation.<sup>5</sup> This would provide a generous tax break to high income individuals who, as explained below, receive the bulk of capital gains income.

Figure 1



Consider, for example, an investor who purchases \$100,000 worth of stock. Figure 1 shows that the portion of the gain that is subject to taxation would be reduced sharply. Assuming an average of three percent inflation and three percent real growth in the value of the stock, the figure shows that if the stock were sold after five years the investor would pay tax on a \$33,820 capital gain under current law. Under the

<sup>5</sup> The Contract plan proposes additional capital gains tax benefits as well, including reductions in the capital gains tax for businesses and reductions for individuals who sustain a loss from the sale or exchange of a principle residence.

Contract proposal, the taxpayer would pay tax on only \$8,950. The amount of gain which escapes taxation grows if the stock is held 10 years and then sold. Under current law, the investor would pay tax at that point on a \$79,085 gain. Under the Contract, only \$22,350 of the gain would be subject to taxation.

This translates into very substantial tax cuts. Assuming again a \$100,000 stock purchase, average annual inflation of three percent, and real annual growth of three percent in the stock's value, an investor in the top income tax bracket who sold the stock after five years would pay \$6,000 less in income tax under the Contract than under current law.

After 10 years, the investor would realize a tax benefit worth nearly \$13,300. By 20 years the benefit of the Contract capital gains tax changes to this investor would jump to about \$34,000. If the average inflation rate exceeded three percent, the tax benefits would be even greater.

**Table 1**  
**The Contract Capital Gains**  
**Tax Benefits Grow Sharply Over Time**

	Selling Price	Tax Under Current Law	Tax Under Contract Proposals	Tax Savings
Initial Investment	\$100,000			
Year 1	\$106,000	\$1,680	\$590	\$1,090
Year 5	\$133,800	\$9,470	\$3,540	\$5,930
Year 10	\$179,100	\$22,140	\$8,850	\$13,290
Year 15	\$239,700	\$39,100	\$16,600	\$22,500
Year 20	\$320,700	\$61,800	\$27,740	\$34,060

Center on Budget and Policy Priorities calculations  
Assumes three percent annual inflation and three percent annual real growth. Rows may not add due to rounding.

*Capital Gains Already Receive Favored Tax Treatment*

Capital gains are already granted favored treatment under the tax code. An estimated three-quarters of all capital gains escape taxation altogether because the gain that accrues during the lifetime of an investor is not taxed if the asset is held until

death.<sup>6</sup> This provides substantial unearned benefits to heirs of mostly wealthy asset-holders.

In addition, unlike income from interest on savings accounts — which is taxed each year regardless of whether the investor withdraws the interest — capital gains are not taxed until the asset is sold. This deferral of tax favors those who invest in stocks and bonds over those who put their (usually much smaller) capital into savings accounts.

Finally, if the capital gain is taxed, current law already provides the equivalent of a 30 percent exclusion for very-high-income investors. Under current law, capital gains income is subject to a maximum tax rate of 28 percent — which is just over 70 percent of the 39.6 percent top marginal tax rate applied to other income. The nontaxation of capital gains at death and the lower maximum rate under current law will cost the Treasury an estimated \$94.2 billion between 1994 and 1998.<sup>7</sup> The Contract proposals would add substantially to that cost.

#### Proposed Capital Gains Rate Lowest in Four Decades

Although capital gains income has enjoyed preferential tax treatment through much of the past four decades, at no time during that period was the maximum effective marginal tax rate — including reductions in the effective rate that resulted from excluding a portion of capital gains from taxation — as low as it would be under the provisions of the Contract. From 1954 through 1967, capital gains income was subject to a maximum effective rate of 25 percent. Maximum tax rates on gains then rose gradually, and in 1976 and 1977 reached 49.1 percent for some taxpayers and 35 percent for other taxpayers. The maximum rate of taxation then declined to 20 percent by 1982 but was increased to 28 percent in 1987, where it remains today. The Contract proposes lowering the maximum rate to 19.8 percent by allowing half of all gains to be excluded from tax. Moreover, while in the past most capital gains income has been taxed at the maximum rate, the indexing provisions of the Contract would insure that almost all gains are taxed at rates *below* the 19.8 percent maximum rate.

#### *Potential for Investment Bias May be Costly*

Despite the fact that various forms of preferential treatment for capital gains have been in place since the 1960s, preferential treatment of capital gains has *not* been shown to stimulate savings or investment. This is largely because most transactions that yield capital gains involve sales of stock between investors. These sales may result in profit for the individual making the sale, but they do not necessarily result in new investment in plant or equipment. In a 1990 study, the Congressional Budget Office found that "cutting taxes on capital gains is not likely to increase saving, investment,

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<sup>6</sup> Henry L. Aaron, *Statement before the Committee on Finance, U.S. Senate, March 28, 1990.*

<sup>7</sup> Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1994 - 1998, April 22, 1993.*

and GNP much if at all," a finding supported by a broad range of tax experts (See box on next page.)

While savings and investment are not likely to be stimulated significantly by capital gains tax advantages, capital gains tax cuts are likely to give rise to economic distortions and investment inefficiencies. A reduced tax on capital gains would cause investors to divert capital to projects that yield capital gains income and away from projects that would produce ordinary business income, because ordinary business income is taxed at a much higher corporate or partnership rate. Rather than encouraging productive new investments, capital gains tax relief turns investors' attention to maximizing tax advantages.<sup>8</sup>

The potential for economic distortion would be particularly strong under the capital gains provisions of the Contract plan, since the Contract combines a 50 percent capital gains exclusion with inflation indexing. When profits from asset sales are indexed but borrowing costs are not adjusted for inflation, an imbalance is created. Taxpayers who purchase assets with borrowed funds would receive a much larger tax break than taxpayers who use other types of funds to purchase assets.

It is common for high-income investors to borrow substantial amounts of funds with which to make large investments. Consider such an investor who borrows \$100,000 to be repaid over ten years at an eight percent rate of interest and uses those funds to purchase \$100,000 worth of stock. Over the lifetime of the loan, the investor's interest payments on the loan will total approximately \$45,000. Current law permits the full amount of these interest payments to be taken as deductions from taxable income.<sup>9</sup>

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<sup>8</sup> One analysis finds that after capital gains taxes were cut and other tax write-offs greatly expanded in 1978 and 1981, investment shifted from productive uses like industrial plant and equipment and into a variety of tax shelters, most notably for commercial real estate. From 1981 to 1986, real investment in commercial real estate climbed at an unusually high annual rate of 6.3 percent, while industrial investment fell 2.7 percent a year. After the capital gains differential was removed and tax sheltering opportunities severely narrowed in the 1986 Tax Reform Act, the situation reversed; industrial investment rose 6.3 percent a year between 1986 and 1989. See Robert McIntyre, *Republican and Democratic Tax Plans*, Citizens for Tax Justice, Nov. 27, 1991.

<sup>9</sup> Although "consumer interest" (such as interest on car loans) may not be deducted from taxable income, "investment interest" may be deducted so long as it does not exceed the amount of investment income reported in the year. If the investment in the example were the only investment the taxpayer had, then the interest on the loan would not be deductible each year because there would be no reported investment income until the stock was sold. By contrast, if the taxpayer had investment income each year from a large portfolio of investments, he or she likely would have had sufficient investment income against which to deduct the yearly investment interest.

## **Capital Gains and IRA Tax Relief Does Little to Promote Savings, Investment or Growth**

An impressive array of tax experts has concluded that tax-advantaged IRAs and cuts in the tax on capital gains income are likely to do little to promote savings and investment. In 1991, the Republican staff of the House Committee on the Budget, under the direction of Representative Bill Gradison, then the Committee's ranking Republican, issued a report examining the relationship between tax incentives — including capital gains tax cuts and IRA expansions — and savings and investment. It found that:

(M)ost evidence suggests that saving is unresponsive to any tax incentives designed to increase it. And capital gains tax cuts and IRAs only affect a small part of saving. Even the most optimistic estimates of the responsiveness of saving to taxes are too low to support the argument that such incentives significantly boost saving and growth.<sup>1</sup>

The House Budget Committee Republican staff also took a close look in 1991 at IRA proposals, including proposals similar to that contained in the Contract. In a report on IRAs, the Republican staff explained that to increase the pool of savings available for investment, an IRA proposal must increase private savings by more than it adds to the federal budget deficit. Otherwise, any additional private savings that are generated will have to be used to soak up the increase in the deficit. But while IRAs are likely to add to the long-term deficit, they cannot be expected to generate a large increase in private savings, the report added; as the Congressional Budget Office has noted, "studies of savings behavior generally have not found that people save significantly more in response to higher after-tax returns." Thus, the Republican staff report concluded that any increase in savings would likely be smaller than the increase in the long-term deficit and that "IRAs are likely to slow long-term economic growth through their effects on the deficit."<sup>3</sup>

Others have examined proposals to cut capital gains taxes and concluded that here, also, the economic benefits touted by supporters of these proposals are dubious. For example, Herbert Stein, Senior Fellow at the American Enterprise Institute and chair of the Council of Economic Advisors under President Nixon, has written that capital gains tax cuts are not likely to promote savings but will result in inefficiencies and tax-avoidance schemes:

Unless cutting the capital gains tax increases the rate of saving, it will only divert investments to projects that can be structured to yield capital gains away from projects that cannot. I see no reason to want such a diversion. On the question whether cutting the capital gains tax would increase saving you can get as many different answers as you can find econometricians. My own view is that the effect would be extremely small, and not worth betting on. In any case, if there is a strong desire to try to increase saving and investment by increasing the after-tax return to

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<sup>1</sup> House Committee on the Budget, Republican Staff Report, *Tax Incentives, Growth and Deficit Reduction, Budget and Economic Analysis*, Volume I, Number 3, November 6, 1991.

<sup>2</sup> Congressional Budget Office, *An Analysis of the President's Budgetary Proposals for Fiscal Year 1992*, March 1991, p. 45.

<sup>3</sup> House Committee on the Budget, Republican Staff Report, *The Truth About IRAs*, Volume 1, Number 4, November 22, 1991.

investment there are, in my opinion, better ways to do that. I think that the only economic consequence we can confidently expect from reducing the capital gains tax is increased activity by lawyers and accountants in converting other income into capital gains.<sup>4</sup>

These views are shared by Henry Aaron, director of economic studies at The Brookings Institution and one of the nation's leading tax experts. Aaron has stated that "tax concessions on capital gains are a remarkably inefficient method of encouraging current real investment."<sup>5</sup> Similarly, Jane Gravelle, a leading tax expert at the Congressional Research Service, observed in testimony in 1992 that capital gains tax cuts cannot be expected to stimulate investment or growth and that their effect on the nation's economic output would likely be negligible.<sup>6</sup>

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<sup>4</sup> *Summary of the Statement of Herbert Stein*, Senior Fellow, American Enterprise Institute, to the House Ways and Means Committee, December 17, 1991.

<sup>5</sup> Henry L. Aaron, *Proposals to Expand a Part of Capital Gains from Taxable Income*, March 28, 1990. See also Henry L. Aaron, "The Capital Gains Tax Cut, Economic Panacea or Just Plan Snakeoil?," *The Brookings Review*, Summer, 1992.

<sup>6</sup> Jane G. Gravelle, Congressional Research Services, *Statement before the Committee on the Budget*, U.S. House of Representatives, February 11, 1992.

The interest payments, however, may be viewed as having two components — a component that compensates the lender for inflation over the period of the loan and a component that represents the amount paid for the privilege of borrowing funds. Only that portion of the interest payment that exceeds the inflation rate represents the real cost of borrowing. In this case, assuming a three percent inflation rate, approximately \$17,000 of the total interest paid represents the inflation component; only \$28,000 represents the real cost of the loan to this investor. Nevertheless, the investor will have taken \$45,000 in tax deductions for interest payments over the life of the loan — deducting \$17,000 beyond the real cost of the loan.

Under current law, the ability of the investor to deduct the full amount of interest paid is balanced by the way in which tax is assessed when the assets that were purchased with the borrowed funds are sold. When the investor sells the stock, current law requires that a tax is paid on the full capital gain and not just on the amount of the gain that exceeds inflation. If, as in the example given above, the investor sells the stock for approximately \$79,000 more than the price paid ten years earlier (assuming a three percent inflation rate and three percent real growth), capital gains tax will be due on the entire \$79,000 — with no downward adjustment to take inflation into account.

Under the Contract proposal, however, the symmetry disappears. In determining how much capital gains tax is due, this investor will be able to adjust the \$79,000 profit downward by approximately \$34,300 to account for inflation. The tax on

capital gains will be lowered substantially even though the investor will have deducted the *full* amount of interest paid over the life of the loan — with no adjustment downward to reflect the inflation component of the interest payments.

In addition to applying the inflation adjustment to the capital gain, the investor will be able to exclude 50 percent of the inflation-adjusted gain. As a result, only about \$22,350 of the \$79,000 would be subject to tax as a capital gain. But an amount exceeding that \$22,350 has already been taken by the investor as interest deductions during the period the stock was held. Since the \$45,000 of interest the investor deducted over the life of the loan far exceeds the \$22,350 capital gain subject to tax, the investor has a negative rate of tax on this investment.

Under the Contract, it is likely that there would be no net taxes on the profits from the investment made with borrowed funds. In addition, since the interest deductions often would exceed the amount of capital gain subject to tax, those deductions could offset taxes on profits from other investments made with non-borrowed funds.

The unequal treatment of the inflation component of interest payments and the inflation component of investment profits would create a considerable windfall for investors. It also would encourage excessive borrowing and distort investment decisions by allowing investors to realize higher rates of returns on otherwise less attractive investments — as long as the investment is accomplished with borrowed funds. Since, by and large, moderate income investors invest savings rather than borrowed funds and only wealthy individuals have access to substantial amounts of borrowed funds, the windfall created by the Contract's indexing proposal predominantly benefits upper-income investors.

#### *Cost of Capital Gains Proposals Grow Over Time*

The Contract capital gains proposals would substantially increase the cost of capital gains preferences. Contract sponsors estimate the cost of the capital gains proposals to be \$56 billion over five years. But this estimate likely understates long-term costs.

For a short period of time, a capital gains tax cut can have a modest cost — or can even increase federal revenues — as investors decide to sell assets sooner than they otherwise might have to take advantage of a new provision, such as the proposal to exclude 50 percent of capital gains profits from taxation. Under a 50 percent exclusion, the maximum 19.8 percent tax rate would be the lowest rate of taxation on such income in the past 40 years. As a consequence, investors are likely to assume the rate might be raised again in the future and be anxious to avail themselves now of the tax break.

The surge in revenues that would result from these transactions, however, will be short-lived. Once the sale of assets stabilizes, the cost of the lower rate of tax on capital gains profits will increase rapidly — both because some of the sales that would have produced future revenues will have already occurred and because the tax per transaction will be cut by more than half as a result of the 50 percent exclusion and indexing.

When the Joint Committee on Taxation analyzed President Bush's more modest 1992 proposal for a maximum 45 percent capital gains exclusion, it found the proposal would lose \$27 billion over a six-year period, or an average of almost \$4.5 billion per year. But the year-by-year trend in revenue gains or losses also told another story — the Joint Committee found an accelerating revenue loss. Revenues would increase by \$3.2 billion during the first two years and then decrease by \$30.3 billion over the following four years. By the sixth year, the annual revenue loss would have been more than twice the average annual loss for the six-year period as a whole. This pattern demonstrates that the revenue losses from capital gains tax cut proposals like those included in the Contract are likely to accelerate sharply over subsequent periods.

Inflation indexing makes the potential for high revenue losses in later years even greater because it removes an ever-increasing amount of capital gains from the tax base. The Joint Committee on Taxation reviewed an indexing proposal by Representative Gingrich in 1991 and found it had a relatively small cost — a total of \$700 million — in the first three years of implementation, but a much larger cost — \$2.6 billion — in the fifth year. Taking this estimate a step further, a recent study by Jane Gravelle of the Congressional Research Service suggests that the cost of capital gains

#### **State Revenues Would Also Be Reduced**

The capital gains and IRA proposals would in many cases reduce *state* as well as federal taxes on individuals with higher incomes. This is because 36 states and the District of Columbia incorporate the federal definition of adjusted gross income (AGI) in their tax codes.

For instance, if a percentage of capital gains were excluded from the definition of AGI, the excluded gains would not be considered income in many states. Similarly, if expanded eligibility for the new type of IRA accounts sheltered interest income from federal taxation, taxable income also would decline in most states.

In addition, the tax codes of 14 states conform to the federal treatment of Social Security benefits. These states' revenues would drop as a result of the Contract's proposal to reduce the proportion of Social Security benefits subject to taxation.

If these Contract provisions were adopted, states could lose billions of dollars in revenue in coming years and could face the same problem the federal government is likely to experience of exploding revenue losses after the year 2000. To offset this revenue loss, states would likely be forced to cut programs, raise taxes, or do both. State spending cuts typically affect low- and moderate-income families the most, while tax increases in most states also are likely to affect low- and middle-income taxpayers disproportionately. Those benefiting the least from the new state tax cuts that would result from federal approval of the Contract proposals likely would be those most adversely affected by the actions states would take to offset the impact on state budgets.

indexing in the fifth year represents about 30 percent of the annual cost that can be expected when losses stabilize.<sup>10</sup> Applying Gravelle's calculations to the Joint Committee estimate of the 1991 Gingrich indexing proposal suggests the eventual cost of indexing could be at least \$40 billion over five years.

Moreover, the Contract proposal will be more costly than the 1991 Gingrich proposal because the earlier Gingrich indexing proposal applied only to assets purchased after the effective date of the legislation. By contrast, the Contract would allow indexing of *all assets* sold after the last day of 1994, including those purchased years ago.<sup>11</sup> This would greatly expand the universe of assets subject to indexing.

Consistent with these earlier analyses, preliminary estimates by the Joint Committee on Taxation of the revenue effects of the Contract capital gains proposals project very large long-term revenue losses. The Joint Committee estimates the 10-year cost of the Contract's proposals for reducing the taxation of capital gains for individuals and corporations at \$208 billion.

Like the estimates of prior, more modest capital gains tax cut proposals, the new JCT estimates of the Contract proposals demonstrate the accelerating nature of the revenue loss. The 50 percent capital gains tax exclusion for individuals is projected by the Joint Committee on Taxation to cost \$26.3 billion over the initial five-year period, mushrooming to a \$79.1 billion loss in the following five years. Indexing would cost \$7.7 billion in the first five years, and the cost would grow to \$40 billion in the second five years.<sup>12</sup> The average annual revenue loss from the 50 percent exclusion would be three times greater in the second five-year period than in the first five-year period. The growth in the average annual loss from indexing is even more pronounced; in the second five years, the average annual cost of indexing would be more than five times as much as the average yearly cost in the first five-year period. (See Figure 2.)

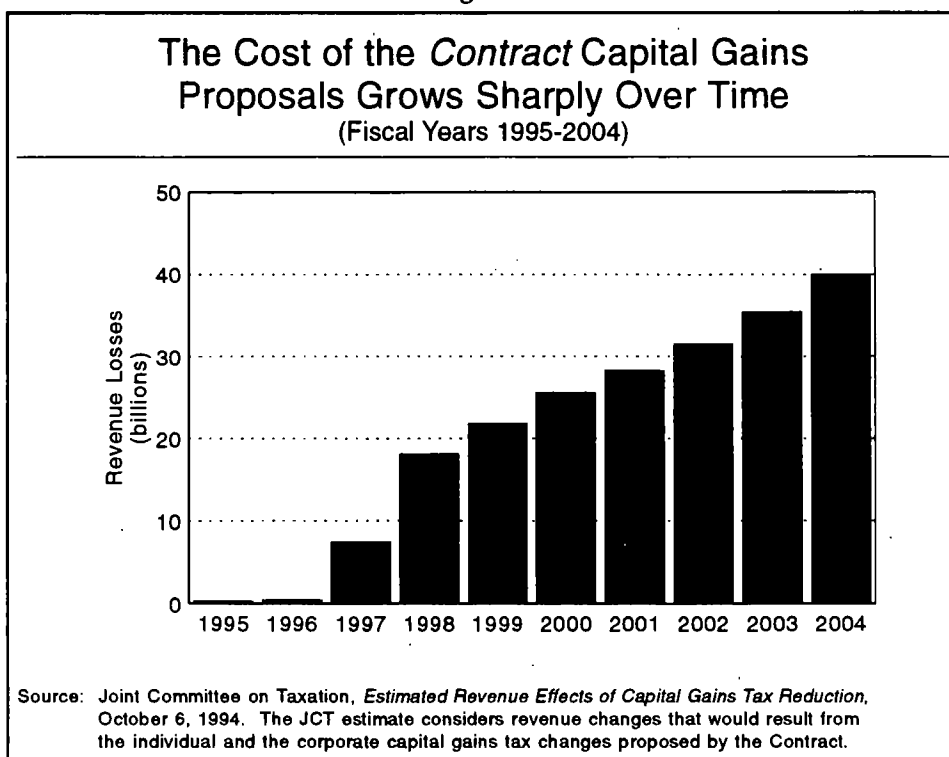
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<sup>10</sup> Jane G. Gravelle, "Estimating Long-Run Revenue Effects of Tax Law Changes," *Eastern Economic Journal*, Vol. 19, No. 4, Fall 1993. Gravelle's analysis uses the historic average of five percent inflation and three percent real growth and calculates that the losses grow over time and then stabilize after 18 years.

<sup>11</sup> For assets purchased before the end of 1994, the inflation adjustment would be calculated beginning with the calendar quarter ending December 31, 1994.

<sup>12</sup> These are estimates of the revenue losses attributable to the capital gains cuts proposed for individuals. Additional 10-year revenue losses of \$14.8 billion would result from extending the 50 percent exclusion to corporations and a \$21.3 billion loss would result from applying the indexing proposal to assets held by corporations. The losses resulting from the individual and corporate tax cuts do not sum to the total because the JCT includes an "interaction effect." The Joint Committee estimates the total cost of the Contract capital gains proposal at \$47.4 billion in the first five years and \$160.7 billion in the second five years. Joint Committee on Taxation, *Estimated Revenue Effects of Capital Gains Tax Reduction*, October 6, 1994. The Joint Committee on Taxation characterizes these estimates as "very preliminary."

Figure 2



### The "Neutral Cost Recovery System"

The Contract also proposes some complex changes in depreciation allowances. Depreciation is the way that businesses account for the use of capital investments such as buildings, machinery and equipment in the production of business income. The proposed changes would increase the amount that businesses can deduct over the useful life of an investment.

In determining their taxable income, businesses are permitted to deduct the cost of capital investments such as buildings, machinery, and equipment. Since these items typically have a useful life of a number of years, their cost is deducted as the asset *depreciates* or wears out. For financial accounting purposes, the cost of machinery and equipment is deducted in equal amounts each year of its expected life. Current tax law, by contrast, allows businesses to deduct the cost of capital investments faster than it wears out, using a system known as "accelerated depreciation." Accelerated depreciation permits some acceleration of deductions into the early years of ownership, with smaller deductions in subsequent years. Total deductions for depreciation, however, are limited to the value of the initial investment. Compared to depreciation

of assets in equal increments over their useful life, current-law accelerated depreciation is estimated to save businesses more than \$100 billion over the next five years.<sup>13</sup>

The "neutral cost recovery system" (NCRS) proposed in the Contract would provide more generous depreciation deductions than current law. NCRS would both allow businesses to continue to use a form of accelerated depreciation *and* allow businesses to adjust the amount of their depreciation deduction upward each year by a percentage that exceeds the rate of inflation. Total deductions would *not* be limited to the initial investment and would exceed the amount of the original investment by a substantial amount in most cases.

Consider the case of equipment purchased for \$10,000 and expected to last for 10 years. Under a straight-line depreciation schedule used for normal accounting purposes, the business could deduct \$1,000 a year for 10 years. Under current-law accelerated depreciation provisions, more than half of the value of the asset may be deducted in the first four years, but lesser amounts are deducted in subsequent years, so total depreciation deductions over the 10 years also equal \$10,000. If the NCRS tax break were in effect, however, the business could inflate the purchase price each year by the rate of inflation plus another 3.5 percent. (The 3.5 percent bonus over the rate of inflation is a number specified in the proposed law. It would not vary with the rate of inflation or economic circumstances.)<sup>14</sup> If the inflation rate were a modest three percent, the business could deduct \$13,500 over the 10-year period — 35 percent more than under current law as a result of the NCRS adjustments. If the inflation rate were five percent, the business would be able to deduct 50 percent more over the life of the asset.

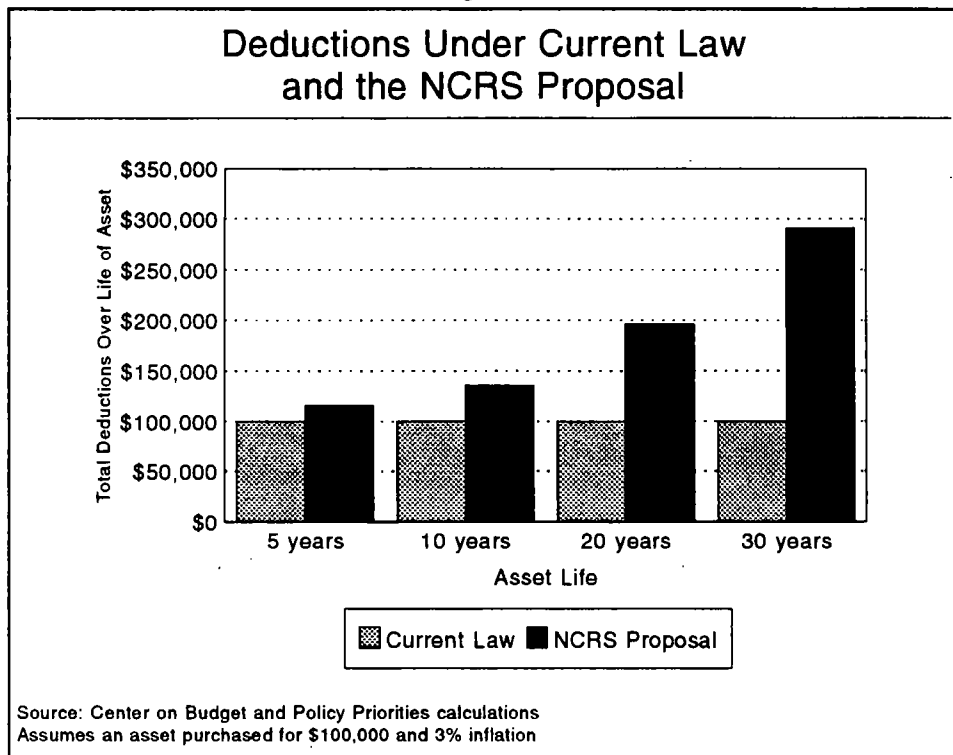
For buildings or equipment expected to last longer than 10 years, the difference between current law deductions and the NCRS system would grow dramatically as a result of the compounding of inflation plus 3.5 percent. Assuming a modest three percent rate of inflation, a business that purchased a \$100,000 building or piece of equipment expected to last 20 years could deduct \$196,000 over 20 years, while a \$100,000 purchase expected to last 30 years would yield \$290,000 in tax deductions. As noted above, at present no more than \$100,000 could be deducted. (See Figure 3.)

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<sup>13</sup> Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 1994-1998*, April 1993.

<sup>14</sup> The 3.5 percent factor is intended to make the depreciation deductions over the life of the asset equivalent to deducting the entire cost of the asset in the year it is purchased. The inflation plus 3.5 percent adjustment in effect pays interest to the business for delaying depreciation deductions beyond the year of purchase.

Figure 3



Despite the large increase in permitted deductions, the Contract lists the proposed depreciation changes as *raising* \$20 billion over the next five years. This large tax cut can raise revenue in the near term because the proposal changes the timing of deductions for shorter-lived assets. For assets that may be depreciated over 10 or fewer years, the degree of permitted acceleration of deductions would be reduced from what is known as the "200-percent declining balance" method to a "150-percent declining balance" method. The 150-percent method currently is used for longer-lived assets. Therefore, while the total amount of allowed depreciation deductions would be greater under NCRS than under current law, for shorter-lived assets the amount of deductions permitted in the first few years would be less than under current law. Since only new assets would be eligible for NCRS, and since shorter-lived assets such as vehicles and computers wear out and are replaced more frequently than longer-lived assets, these short-lived assets will make up the bulk of assets eligible for NCRS in the first few years after implementation.

As longer-lived assets are slowly replaced and depreciated under the compound growth path of NCRS, however, overall depreciation deductions would rise sharply. The cost of NCRS would rise steadily beyond the five-year period. An analysis by the Congressional Research Service of an earlier, identical NCRS proposal found that the proposal could increase the taxable income of business by \$87 billion in the first five

calendar years, but in the long run, after all assets came under the new system, the proposal would reduce taxable income by \$984 billion over a five-year period — an amount in the opposite direction that is 11 times as large. The report notes that with effects this large, it is very difficult to predict changes in tax liability or revenues, since for some firms the depreciation deductions would exceed the taxable income that could be offset by the deductions. But there is little question the long-term revenue loss would be quite substantial.<sup>15</sup>

A Joint Committee on Taxation estimate of a 1991 depreciation proposal gives some indication of the revenue impact beyond the five-year budget period. The proposal that was analyzed included the adjustment of deductions for inflation plus 3.5 percent, but did not include the change in the accelerated depreciation for short-lived assets — so the immediate cost of the proposal was not masked. The Joint Committee on Taxation estimated that proposal to cost \$58 billion over its first five years.<sup>16</sup> The contract proposal is likely to cost at least that much in subsequent five-year periods.

### **Impact on Deficit Reduction**

The revenue reductions in the Contract are estimated by its sponsors to cost more than \$190 billion over the first five years. As discussed above, the cost in subsequent years is likely to be much greater. The cost of the IRA, capital gains, and depreciation proposals in the Contract, which are said to have a net cost of \$31 billion in their first five years, could have combined cost in subsequent five-year periods of more than \$260 billion — \$50 billion for the new-style IRAs, \$160 billion for the reduction in capital gains taxation, and \$58 billion for the more generous depreciation allowances. If the costs of all other tax provisions in the Contract remained constant at \$159 billion, the cost in subsequent five-year periods could exceed \$400 billion.

The sponsors do not indicate how the majority of these cuts will be financed. Nevertheless, they call for a constitutional amendment requiring a balanced budget by the year 2002. According to the Congressional Budget Office, balancing the budget gradually over a five-year period would require spending cuts or tax increases totalling approximately \$750 billion. Balancing the budget gradually over a seven-year period would require spending cuts or tax increases totalling approximately \$1,200 billion. These spending cuts or tax increases would be in addition to those needed to pay for the revenue reductions proposed by the Contract.

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<sup>15</sup> Jane G. Gravelle, *Background Information on the Neutral Cost Recovery Proposal*, Congressional Research Service, March 8, 1994.

<sup>16</sup> Joint Committee on Taxation analysis of Kasten-Weber Tax Incentive Plan, 1991.

Substantial progress has been made in recent years in reducing the federal budget deficit, but that progress has required difficult tax increases and painful budget cuts. In its most recent analysis, the Congressional Budget Office projected that the 1995 deficit will be a smaller share of GDP — 2.3 percent — than in any year since 1979. As a result of the 1990 and 1993 budget reconciliation laws and recent economic growth, the deficit as a share of GDP will have been more than halved since 1992, when it stood at 4.9 percent. And despite the Clinton Administration's proposals to increase funding for various domestic programs identified as investment initiatives, total spending for domestic non-entitlement programs will — by fiscal year 1998 — constitute a *lower percentage of GDP than in any year since 1962.*<sup>17</sup>

Under current forecasts, just maintaining the progress that has been achieved will be difficult. In the absence of health care reform, further deficit reduction action will be required to keep health care costs from driving the deficit higher by the end of the decade. Maintaining or improving the progress on deficit reduction is important. Most economists believe the nation is now better prepared to tackle the challenges posed by a global economy and better able to invest in the future of our workers and businesses as a result of the lower deficit.

The Contract puts further progress in question. Over the next five years, potential budget savings would be devoted to paying for tax cuts, rather than continuing progress on deficit reduction. And outside the five-year budget window, the deficit likely would increase sharply unless massive cuts in domestic spending programs were made.

As noted above, the Contract does not specify how the bulk of the tax cuts would be offset with spending cuts or other tax revenues, either within the five-year budget horizon or beyond that period. The sponsors suggest, however, that the financing could include budget cuts along the lines of earlier proposals with which some of the sponsors have been associated. In particular, some sponsors have pointed to a budget plan developed in Spring 1994 by Representative John Kasich that contained substantial budget cuts.

But many of the budget cuts in that plan would prove extremely difficult to achieve as they would fall heavily on the middle class. Elderly Medicare beneficiaries with incomes above \$11,000 a year for individuals and \$15,000 a year for couples would pay significantly more for certain health care costs, large numbers of middle-income

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<sup>17</sup> The 1990 and 1993 budget reconciliation acts set strict caps on discretionary (non-entitlement) spending through fiscal year 1998. To comply with these caps, the Clinton Administration's fiscal year 1995 budget eliminated or reduced spending for various programs considered to be low priorities in order to increase spending for the Administration's high-priority programs, such as crime control, infrastructure, Head Start, and national service.

students would have to make significantly higher payments for student loans, and support for school lunches for middle-income students would be eliminated. (These proposals are discussed in more detail in the next section.) Proposals similar to these have faced overwhelming bipartisan opposition in the past.

Moreover, cuts such as these would be only the tip of the iceberg. They would be tiny compared to the cuts that would be required to pay for the new tax cuts and balance the budget in years after 2000. If the budget gaps that would result had to be closed without raising taxes, cutting defense, or touching Social Security, areas that many Contract proponents have said should be immune from deficit reduction measures — the reductions in the rest of the budget and especially in entitlement programs that principally benefit the middle class would have to be massive. The benefits provided to millions of primarily middle-class Americans under programs such as Medicare, veterans programs benefits, student loans, and programs providing retirement benefit for civilian and military employees would face reductions of unprecedented severity. Otherwise, the numbers would not add up.

### **Impact on the Medicare Trust Fund**

The Contract includes a provision that would lower the taxes of the highest-income 13 percent of Social Security beneficiaries, reversing changes made in the 1993 budget reconciliation act. In 1993, Congress increased the percentage of Social Security benefits subject to taxation from 50 percent to 85 percent for single taxpayers with annual incomes above \$34,000 and for married couples with annual incomes above \$44,000. This step was taken to improve the financial condition of the Medicare Trust Fund, reduce the deficit, and control the growth in entitlement costs.

The Contract proposes repealing these changes at a cost of \$17 billion over five years. The repeal would be phased in gradually over the five-year period, so here, also, the cost in subsequent five-year periods would be somewhat higher — approximately \$25 billion.<sup>18</sup>

Funds from the taxes collected as a result of the 1993 law are deposited directly in the Hospital Insurance (Medicare) Trust Fund. Repeal of the law thus would weaken the trust fund's financial condition.

The most recent report of the Social Security actuaries finds that the Medicare Trust Fund is out of long-term balance. Without changes to reduce Medicare costs or

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<sup>18</sup> The 1993 law change was estimated by the Joint Committee on Taxation to raise \$25 billion over five years.

increase the revenue flowing into the trust fund, the Medicare Trust Fund will be insolvent by 2001. This loss of tax revenue would push Medicare further out of balance. Offsetting actions, such as reductions in Medicare benefits or increases in taxes deposited in the trust fund, would be required as part of future efforts to avert insolvency.

### **Distribution of Costs and Benefits**

Low- and middle-income households will receive little benefit from the expensive changes in IRA provisions and capital gains taxation proposed in the Contract. Middle-income taxpayers would stand to benefit from the child tax credit included in the Contract. At the same time, however, it is likely that a number of federal programs primarily benefitting middle-income households would ultimately have to be cut to compensate for the cost of the tax cuts, particularly beyond the five-year budget period. Overall, high-income taxpayers would reap large gains, while low-income households would lose ground. The effects on middle-income households are unclear. Middle-income households could face a loss in disposable income if benefits they receive are reduced by more than their taxes are cut.

### **Higher-Income Taxpayers**

While proposals to expand IRAs are often described as middle-class tax cuts, they are, in fact, primarily tax breaks for the affluent. A Joint Tax Committee analysis of earlier IRA proposals found that the benefits from restoring universal full-IRA deductibility would accrue overwhelmingly to higher-income people; not to the middle class.<sup>19</sup>

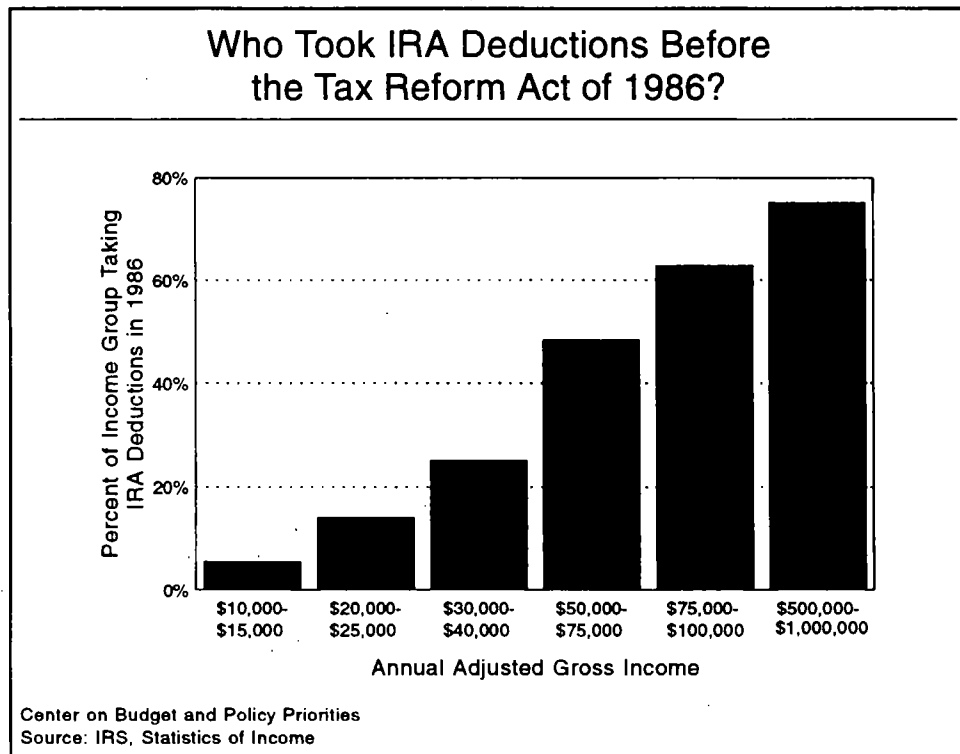
- The top one-fifth of taxpayers would receive approximately 95 percent of the tax benefits from restoring universal eligibility for IRAs.
- The wealthiest five percent of taxpayers — those with incomes of at least \$100,000 — would collect nearly one-third of the tax benefits.

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<sup>19</sup> These data are based on Joint Committee on Taxation estimates from 1989. The Joint Committee has not provided similar data since then. The data are based on 1990 income levels and tax laws and on a proposal to make IRA's only 50 percent deductible for taxpayers who lost deductibility under the Tax Reform Act of 1986. These estimates are likely to *understate* the share of benefits received by high-income taxpayers, because the 1993 budget reconciliation act raised the marginal tax rates on the highest-income Americans and therefore increased the tax benefits of IRA contributions for this group.

Several factors explain why the tax benefits of IRA expansion proposals are so skewed in this manner. First, most middle- and lower-income taxpayers are already eligible for IRA tax deductions. In 1995, more than 70 percent of taxpayers with earnings will be eligible for an up-front tax deduction for IRA contributions. Second, the higher a taxpayer's income level, the more likely the taxpayer is to have money to save and thus to use for IRA deductions. In 1986, the last year that IRA deductions were available to all taxpayers, 66 percent of the tax filers in the top four percent of the income scale made IRA contributions, but only 13 percent of those in the middle third of the income scale did. (See Figure 4.) Finally, the higher an individual's tax bracket, the greater the tax benefit derived from an IRA deduction. An IRA deduction is worth more than twice as much to high-income people in the 36 percent or 39.6 percent tax brackets — taxpayers with incomes over \$115,000 — as it is to middle-income people in the 15 percent tax bracket.

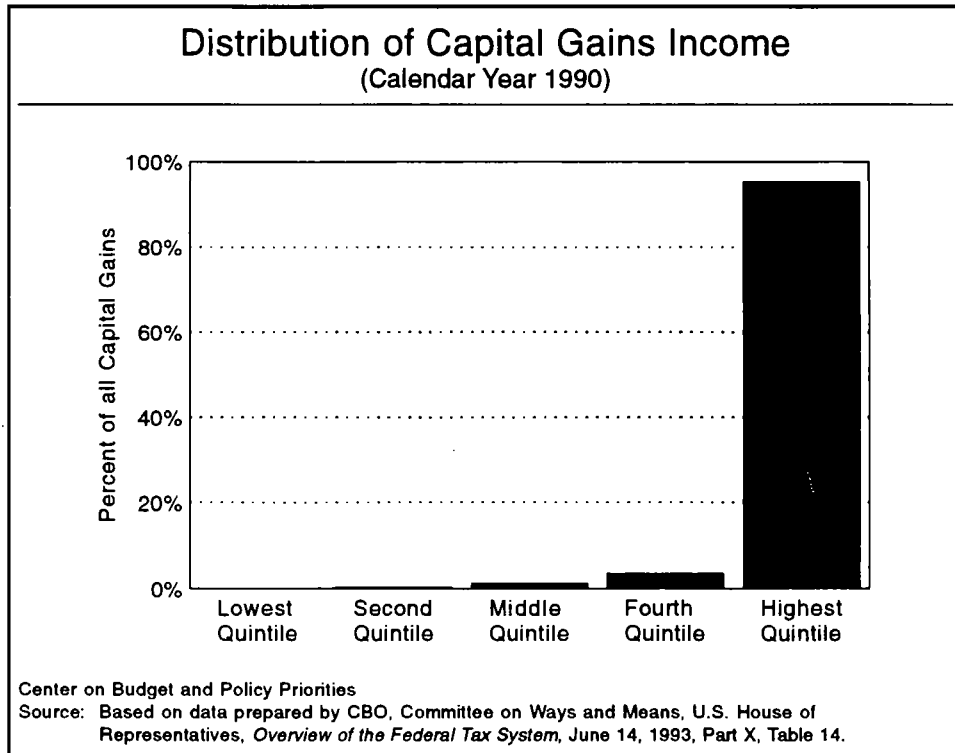
Figure 4



Capital gains tax relief is likely to accrue to an even smaller portion of taxpayers than would the benefits from expanded IRAs. Proposals to cut capital gains taxes benefit primarily the wealthiest Americans because the distribution of capital gains income is so highly skewed; higher-income households are far more likely to have investment income that can yield capital gains income than other households.

Moreover, among those who have capital gains income, the average amount of capital gains income received by high-income investors is much greater than the average amount realized by middle-income investors. (See Figure 5.)

Figure 5



The Joint Committee on Taxation considered the distribution of the tax benefits that would have resulted from President Bush's 1992 capital gains proposal to allow a 45 percent exclusion of the gain realized on certain assets.<sup>20</sup> The Committee's data show the following distribution:

<sup>20</sup> Joint Committee on Taxation estimates of the *Distributional Effects of the Administration's Capital Gains Proposal*, February 3, 1992. The proposal that was examined would have provided for a 45 percent exclusion from income of the gain realized on certain qualified assets. In placing households into various income categories, household income included adjusted gross income plus tax-exempt interest, employer contributions for health plans, inside buildup on life insurance, workers compensation, nontaxable social security benefits, deductible contributions to IRAs, minimum tax preferences, and net losses in excess of minimum tax preferences from passive business activities. Households include filers and nonfilers. Since the tax reduction reported assumes no change in taxpayer behavior, the Joint Committee's estimates understates the tax benefit received by certain taxpayers who alter behavior to maximize their gains.

- Less than four percent of households with incomes between \$20,000 and \$30,000 would receive any benefit from the tax cut, and their average benefit would be \$180. Some seven percent of households with incomes between \$30,000 and \$40,000 would benefit from the tax cut, receiving an average benefit of about \$300. Hardly any tax benefits would go to those with incomes under \$20,000.
- By contrast, close to one-third of households with incomes between \$100,000 and \$200,000 would receive an average tax cut worth \$1,250. And the 44 percent of households with incomes of \$200,000 or more that report capital gains profits would receive an average benefit of \$8,478.
- Looked at another way, 70 percent of the total benefit from the tax cut would go to households with incomes of \$100,000 or more, who constituted the top five percent of households.
- And the top one percent of taxpayers — those with incomes of at least \$200,000 — would capture more than half of the total tax benefits from the capital gains exclusion.

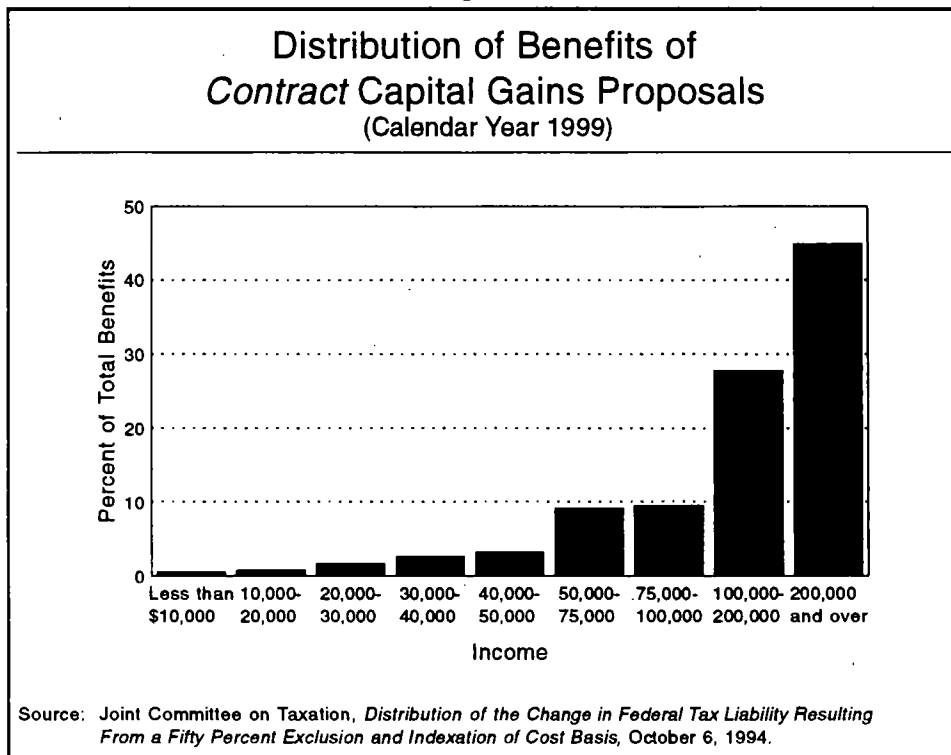
The distribution of tax benefits resulting from proposals to index capital gains for inflation is also tilted in favor of the wealthy. When the Joint Tax Committee analyzed an indexing proposal in 1992, it found that a little more than half the benefits would accrue to the wealthiest one percent of taxpayers — those with incomes \$200,000 or more.<sup>21</sup>

The lopsided distribution of benefits is also apparent in the analysis the Joint Committee on Taxation recently conducted of the combined effect of the Contract's capital gains exclusion and indexing proposal. The Committee's data show that less than six percent of the total tax benefit would accrue to households with income under \$40,000, while nearly 45 percent of the benefit would go to households with incomes over \$200,000. Almost three-fourths of all the benefits would go to those with incomes of \$100,000 or more. (See Figure 6.)

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<sup>21</sup> Joint Committee on Taxation, *Distributional Effect of Indexing the Cost Basis of Certain Capital Assets*, February 18, 1992. The analysis assumes indexing is fully phased in, with annual inflation equal to the average rate assumed by the Congressional Budget Office for the 1992 - 1997 budget period. Income is adjusted gross income, plus the items noted in footnote 20.

Figure 6



In short, wealthy individuals and families would be large winners under the Contract. If government benefit programs were reduced to help pay for the tax cuts, it would not be possible to recapture from those at high-income levels more than a small fraction of the value of the tax cuts they would obtain. The wealthiest households do not receive a large enough proportion of entitlement benefits for that to be done. Moreover, upper income households secure a smaller percentage of their income from government benefits than average families at middle- and lower-income levels do, and so would be affected the least by benefit reductions.

### **Middle-Income Families**

In addition to the large tax reductions for upper-income households and corporations, the Contract proposes a children's tax credit. Under this proposal, a \$500 tax credit would be allowed for each child in families with adjusted gross income up to \$200,000 a year. The credit would gradually phase out for families with incomes between \$200,000 and \$250,000; families with incomes exceeding \$250,000 would be ineligible for the credit.

The children's credit would immediately benefit many middle-income families. For families with federal income tax liability, the credit would result in a reduction in taxes. And in limited circumstances, the credit would be refundable for some moderate-income families with insufficient tax liability to utilize the entire credit as an offset to taxes owed.<sup>22</sup>

Whether middle-income families are better off under the Contract in the long-term, however, would depend on how the costs of the tax cuts are financed, especially in future years when the costs of the tax cuts that primarily benefit upper-income households and corporations would grow rapidly.

If the budget gaps that resulted from the need to pay for the new tax cuts and balance the budget in years after 2002 had to be closed without raising taxes, cutting defense, or cutting Social Security, the reductions in the rest of the budget would have to be extremely large. As noted above, the benefits provided to middle-class Americans under programs such as Medicare, veterans benefits, farm programs, student loans, and retirement benefits for current civilian and military employees would likely face reductions of unprecedented depth. If financing the tax cuts ultimately requires sharp reductions in programs from which middle-income families benefit, significant numbers of middle-income families might find their incomes reduced or their expenses increased as a result of such offsetting actions. (See box on next page.)

### Lower-Income Families

Low-income households are the clear losers under the Contract. They would gain little from the tax proposals and bear a disproportionate share of the burden of the

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<sup>22</sup> Many moderate-income families whose income taxes are reduced or eliminated by the earned income credit would not have sufficient tax liability to utilize the entire child credit to which they otherwise would be entitled. The credit is refundable only to the extent that a household's income tax liability plus its employee and employer FICA (Social Security and Medicare) contributions exceed its earned income credit. Had the proposed children's credit been in effect for 1994, families of four with two qualifying children and incomes between \$15,640 and \$22,817 would have received some benefit from the credit being partially refundable. For example, a family of four with earnings of \$20,000 would have 1994 income tax liability of \$578 before application of its EIC. The combined employer and employee FICA taxes on the \$20,000 of earnings would total \$3,060, bringing total income and FICA taxes, before the EITC, to \$3,638. Since the EIC of \$1,475 to which the family was entitled was \$2,163 less than this, the family would have been entitled to receive the portion of its children's credit that exceeded its income tax as a refund. (Families of four with incomes above \$22,817 will have income tax liability exceeding \$1,000 in 1994, and so would receive their entire children's credit as an offset their income tax income tax. Families of four with incomes below \$17,730 would receive some but not all of the credit through a combination of a tax offset and a partial refund, while families of four with incomes below \$15,640 would receive no benefit from the children's credit.)

## **The Kasich Budget Cuts and Middle-Class Households**

Some leading supporters of the Contract have pointed to the budget plans drawn up in the past two years by Representative John Kasich as examples of ways in which the budget could be cut. Many of the reductions in the Kasich plan would affect the middle class. A few examples follow.

- Under the Kasich plan, the middle-class elderly would pay more for health care. For example, the plan would make all elderly and disabled Medicare beneficiaries with incomes above about \$11,000 a year for individuals and \$15,000 for couples pay 20 percent of the costs of clinical laboratory fees as well as 20 percent of the costs of home health care. Over the next five years, that would require Medicare recipients to pay \$21 billion more, with most of these payments coming from middle-class elderly and disabled people. Those who have illnesses or health conditions requiring substantial attention and only modest incomes could be significantly affected.
- Middle-income students with student loans would be charged interest on the loans while they are in college. Currently, interest charges begin to accrue after a student leaves school. Under the Kasich proposal, the payment on these additional interest charges would be deferred until the student left school, but middle-class students would owe substantially more to the government than at present once they are out of school.
- All federal support would cease for school lunches provided to children with family incomes above 185 percent of the poverty line — or above \$22,800 for a family of three and \$27,400 for a family of four. The price of school lunch for these children would rise at least 30 cents a day. A middle-class family with two children would pay over \$100 more per year for school lunches.
- Substantial cuts in federal support for mass transit could result in fewer transit routes, higher fares, or higher state or local taxes. People using public recreation areas such as national parks also would pay more.
- Retirement benefits would be reduced substantially for all people entering federal employment after October 1, 1994. The federal contributions to their pensions would be reduced. In addition, no retirement benefits would be paid before age 65. For those entering the military after October 1, 1994, no cost-of-living adjustments would be paid before age 62.

resulting cuts in federal programs. The principal spending cuts specified in the Contract are \$40 billion over five years from reductions in AFDC, Supplemental Security Income, public housing, and nutrition programs for the poor.

The proposals in the Contract thus would likely exacerbate recent trends in income disparities. From 1977 to 1990, the average after-tax income of the richest one percent of American households doubled, after adjusting for inflation, while the income of the average American household in the middle fifth of the income distribution rose a scant three percent, and the income of the lowest-income fifth of American households dropped 12 percent.<sup>23</sup> The benefits of key tax proposals in the Contract, such as the new IRA and the capital gains taxation changes, would accrue to the groups that have fared the best in income growth over the past decade and a half.

While tax policies have not caused the widening gap in before-tax incomes, they have contributed to the disparities in after-tax incomes. Between 1977 and 1990, the richest Americans received large tax reductions, while middle-income Americans did not. A study by the Congressional Budget Office shows that for most households — the bottom four-fifths of the income distribution — the percentage of income paid in federal taxes was about the same in 1990 as in 1977. Among the wealthiest one percent of the population, however, the percentage of income paid in federal taxes fell one-fourth.

Since 1990, most of the lost progressivity in the federal income tax has been restored. The largest tax increases in both the 1990 and 1993 budget packages were targeted on those with the highest incomes. In addition, both packages reduced the taxes of low- and moderate-income working families by expanding the earned income credit. Even so, the wealthiest one percent of Americans will still pay a modestly smaller share of their income in federal taxes in 1995 than in 1977. The Contract, with its restoration of IRA tax breaks for higher-income taxpayers, dramatic reduction of taxes on capital gains income, and substantially more generous depreciation deductions, would exacerbate the growing income gap and reverse much of the progress in restoring fairness in the tax code.

## **Conclusion**

The rapidly escalating revenue losses under the Contract for tax cuts primarily benefitting upper-income households would risk increasing the federal budget deficit substantially in future years. If the deficit were allowed to rise substantially, long-term economic growth and competitiveness likely would be affected. If offsetting actions were taken to prevent the deficit from rising — and, in fact, also to balance the budget as the Contract proposes — the magnitude of the budget reductions required would be unprecedented. Budget reductions this deep could not be achieved without very substantial cuts in an array of programs on which middle-income and poor households rely.

*Revised November 9, 1994*

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<sup>23</sup> Congressional Budget Office data, Committee on Ways and Means, 1993 *Green Book*, p. 1500.

## BILLIONAIRES TAX ESCAPE

*The Billionaire Expatriates Tax Escape shows what the 100 Days are all about. Republicans have fought and succeeded in dropping a tax provision designed to prevent 24 multimillionaires from escaping \$1.4 billion in taxes by renouncing their citizenship.*

**PROTECTING THE VERY WEALTHIEST.** The provision would have applied only to multimillionaires--overwhelmingly, in fact, to billionaires. Specifically, the provision would have taxed only capital gains over \$600,000. In order to have capital gains at that level, it's estimated that individuals must have at least \$5 million in assets.

**PROTECTING THE FEW.** Only about 24 very wealthy people per year would have been affected by the tax provision.

**HUGE TAX BREAKS FOR THE WEALTHIEST FEW.** Over 10 years, this proposal would have required billionaires avoiding U.S. taxes to pay an average of \$150 million each in taxes due. By fighting off this provision, Republicans protected a \$150 million tax break per wealthy individual for about 24 individuals per year.

**ANSWERING TO SPECIAL INTEREST LOBBYISTS.** Two former Republican members of Congress with significant tax-writing responsibilities actively lobbied their former colleagues on behalf of specific, wealthy individuals living abroad.

**NOT SERIOUS ABOUT DEFICIT REDUCTION.** The provision would have raised \$3.6 billion (10 years)--but cutting the deficit takes a backseat to protecting the wealthiest.

**BACKGROUND.** Each year, a handful of extremely wealthy individuals renounce their U.S. citizenship specifically to avoid paying U.S. taxes on U.S. taxable income. These individuals are able to avoid paying any taxes on profits they made in the United States while enjoying all the benefits of U.S. citizenship and the U.S. economy. Their situations are very different from those of the hundreds of middle-income people who abandon their citizenship for reasons other than tax avoidance, such as wanting to become citizens of countries that do not permit dual citizenship. In order to avoid taxes that are standard in the industrialized world, these individuals often move to less developed countries such as Belize, St. Kitts-Nevis, and Turks and Caicos. Other key points:

**Comparison with Soviet Jewry an Insult.** Unlike persecuted Soviet Jews, these Americans can enjoy all the privileges of U.S. citizenship, including their wealth, if they will just pay taxes like all other Americans. They choose to leave entirely of their own free will. They can come back of their own free will. And, even once they have left, they can spend up to 120 days per year here in the United States.

**Gains Earned While Enjoying Protections of U.S. Citizenship.** Individuals born in the United States who expatriate are avoiding taxes on gains accrued entirely while enjoying the privileges and protections of U.S. citizenship.

**Most of the Gains Generated in the U.S.** Most of the gains by these expatriates will have been made in the United States, largely as a result of our strong economy, our educated workforce, and our stable society.

**Exceptions for Real Estate and Pensions.** The proposal even includes certain exceptions: one for U.S. real property and one for pensions.

**WHAT'S WRONG WITH THE "CONTRACT" TAX CUTS**

ISSUE	CONTRACT WITH AMERICA TAX RELIEF ACT						
Five-Year Cost	\$178 billion						
Ten-Year Cost	\$630 billion						
Percent of Tax Cuts for Those Earning Over \$100,000	51.5%						
Percent of Tax Cuts for Top 1% (1.1 million families earning more than \$350,000)	20.0%						
Top 1% (1.1 million families) Get Larger Share of Benefits Than Bottom 60% (65.2 million families)	<table border="0"> <tr> <td><u>Families</u></td> <td><u>Benefits</u></td> </tr> <tr> <td>Top 1%:</td> <td>20.0%</td> </tr> <tr> <td>Bottom 60%:</td> <td>15.6%</td> </tr> </table>	<u>Families</u>	<u>Benefits</u>	Top 1%:	20.0%	Bottom 60%:	15.6%
<u>Families</u>	<u>Benefits</u>						
Top 1%:	20.0%						
Bottom 60%:	15.6%						
How Much Bigger Is Average Tax Cut for Top 1% Than for Bottom 60%	76 times (\$20,362 versus \$267)						
Percent of Capital Gains Tax Cut for Top 1%	45.9%						
Child Tax Credit Smaller Than Four Tax Cuts for the Wealthy and Corporations (Neutral Cost Recovery, Capital Gains, AMT repeal, Gift and Estate)	\$235 billion versus \$268 billion						
Joint Committee on Taxation Analysis Excludes Corporate Tax Cuts; Still Shows More Benefits for Top 10% Than Bottom 80% in Year 2000	<table border="0"> <tr> <td><u>Taxpayers</u></td> <td><u>Benefits</u></td> </tr> <tr> <td>Top 10%</td> <td>\$22.7b</td> </tr> <tr> <td>Bottom 80%</td> <td>\$21.6b</td> </tr> </table>	<u>Taxpayers</u>	<u>Benefits</u>	Top 10%	\$22.7b	Bottom 80%	\$21.6b
<u>Taxpayers</u>	<u>Benefits</u>						
Top 10%	\$22.7b						
Bottom 80%	\$21.6b						

**MAJOR CUTS FOR CHILDREN AMOUNT TO TINY FRACTION OF TAX CUTS FOR WEALTHIEST**

Average 1 Year Cost of Contract's Capital Gains Tax Cut	\$9.2 billion
Savings from Rescissions of AmeriCorps, Summer Jobs, WIC, Goals 2000, and Safe and Drug Free Schools	\$2.8 billion
Savings from Rescissions Above as a Percentage of 1 Year Cost of Contract's Capital Gains Tax Cut	30%

**PRESIDENT'S TAX BREAKS TARGET THE MIDDLE CLASS, NOT THE WEALTHIEST**

ISSUE	PRESIDENT'S MIDDLE CLASS BILL OF RIGHTS	CONTRACT WITH AMERICA
Ten-Year Cost	\$172 billion	\$630 billion
Tax Cuts for Those Earning Under \$100,000	84.6%	48.5%
Tax Cuts for Top 1%	(*)	20.0% (\$20,362 per family)

(\*) Less than one-half of one percent. Sources: Department of Treasury; Joint Committee on Taxation (3/28/95)

## HOUSE REPUBLICANS: CUTTING EDUCATION AND TRAINING TO PAY FOR TAX BREAKS FOR THE WEALTHY

Republicans still have not presented a budget with the \$1.6 trillion in savings needed to fulfill their promises to cut taxes and balance the budget. However, Republican efforts to date do reflect a pattern: paying for tax cuts heavily targeted at the wealthiest by cutting spending for education and training. *The New York Times* calls these "the deepest cuts proposed for education spending in more than a decade." The cuts include:

- Budget Committee Chairman John Kasich's "illustrative spending cuts," which make deep reductions in job training and Goals 2000.
- The House welfare and child block grants, which cut child nutrition in school.
- The House rescissions, which gut national service and funding for drug-free schools. While the bill theoretically will put savings in a deficit "lockbox," Kasich has said that the lockbox is a "game" that will be "dropped"--thus admitting that the savings are necessary because of the tax cuts.

### BIG TAX CUTS FOR THE WEALTHY

The "Contract with America Tax Relief Act" includes \$630 billion in tax cuts over 10 years --with 51.5% of the benefits going to families making over \$100,000 (Treasury estimates).

- The wealthiest 1% (1.1 million families making over \$350,000) get more tax breaks than the bottom 60%--over 65 million families.
- The average tax cut for the wealthiest 1% is over \$20,000--over 75 times bigger than the average break for the 65 million families in the bottom 60%.
- Over a quarter trillion dollars of the tax cuts are targeted almost entirely at the very wealthy and large corporations: a capital gains tax cut (\$92 billion) with 46% of benefits for the top 1% of Americans; a "neutral cost recovery system" that will encourage distorting, tax-sheltering activities (\$120 b); repeal of the corporate Alternative Minimum Tax, designed to prevent major companies from paying no taxes (\$36 b); and cuts in the gift and estate tax (\$23 b).

### DEEP CUTS IN EDUCATION

The cuts below are just a *sampling* of the Republicans' proposals for education. Cuts show 5-year savings for block grants and Kasich's cuts and 1-year savings for rescissions.

#### 1. K-12 EDUCATION

- Cut Goals 2000 (\$174 million rescission; further cuts by Kasich in Goals 2000 and School-to-Work total \$723 million). The rescission alone would cut off funds for 4,000 schools to raise academic standards and improve teaching. Specifically eliminated are parental assistance initiatives to ensure that parents play a strong role in school improvement.
- Eliminate Drug-Free Schools and Communities funding (\$472 million rescission). These funds help schools prevent drug use and violence, through efforts that include buying metal detectors and hiring security personnel.

- **Cut School Lunches and Breakfasts** (\$2.3 billion block grant cut). The Republicans accept CBO scoring that shows \$2.3 billion in savings from their "School Nutrition block grant," with only 2.5% growth in 1996. That rate is inadequate to keep pace with annual inflation (3.2%) and increases in the number of children (1.6%). Had the block grant been in place in 1989, over 1 million children who received nutritious free lunches in 1994 could not have gotten them. Since the block grant provides inadequate funding in case of recession and eliminates nutritional standards and guaranteed free lunches for poor children, the result will be either lower quality meals or fewer children served, or both.
- **Cut Education Technology and Improvement** (Kasich cuts \$214 million above a \$97 million rescission). Most of these funds help schools to put state-of-the-art technology and computers in classrooms. Some funding is for building and supporting public libraries.
- **Cut Teacher Training in Math and Science** (Rescission cuts \$100 million). Eisenhower grants help teachers develop top skills for teaching core subjects like math and science.
- **Eliminate the Department of Education.** Republican leaders, including Speaker Gingrich and Majority Leader Dole, have called for eliminating the Department and its programs. This would not just cut "bureaucracy," but would slash billions of dollars in education aid.

## 2. JOB TRAINING

- **Cut Education, Training and Employment Services** (Kasich cuts \$10.2 billion above rescissions, including literacy and adult education). President Clinton has proposed a major consolidation that will put funds directly into workers' hands as Skill Grants. The cuts would eliminate over 3 million training opportunities and Skill Grants.
- **Cut School-to-Work** (Kasich cuts \$723 million above rescissions from this program and Goals 2000 together). These funds support a 50-state movement that is creating thousands of paths out of high school and into jobs with good wages and a future. This proposal would delay reforms in 22 states not already receiving support.

## 3. NATIONAL SERVICE

- **Gut AmeriCorps** (rescission would cut the program by \$416 million, or 72%; Kasich would cut an additional \$681 million). The rescission would break a contract with tens of thousands of young people serving their communities and earning aid for education. This year and next, 30,000 young people would be sent home or prevented from serving, and over 100,000 young people would lose the chance to serve over the next 5 years.

## 4. STUDENT AID

- **Eliminate Student Loan In-School Interest Subsidy for 4 million students:** (Kasich's 1995 budget proposal and "Contract with America" options from September 1994: \$9.6 billion). For a four-year student who borrowed the maximum amount (\$17,125) at the maximum interest rate (8.25%), this proposal would increase costs by \$3,150--18 percent.
- **Cut back the new Direct Lending program.** By cutting out middlemen, the initiative has saved billions of dollars for taxpayers, lowered costs for students, and allowed borrowers to choose flexible repayments like pay-as-you-earn. Leading Republicans want to limit the program and prevent hundreds of schools and millions of students from participating.

**DRAFT**

## **CONTRACT PROVIDES HUGE TAX BREAKS TARGETED AT CORPORATIONS AND WEALTHIEST**

**THE REPUBLICAN TAX BILL INCLUDES OVER A QUARTER OF A TRILLION DOLLARS IN TAX BREAKS TARGETED ALMOST ENTIRELY AT THE VERY WEALTHY AND LARGE CORPORATIONS--NOT AT MIDDLE-CLASS FAMILIES.** The following four tax breaks account for over 40% of the costs of the Contract over 10 years--over \$265 billion (Treasury estimates):

1. **A CAPITAL GAINS TAX CUT**, including indexing for inflation, with 46% of benefits for the top 1% of Americans and over three-quarters of benefits for those making over \$100,000 (\$92 billion).
2. **A NEUTRAL COST RECOVERY SYSTEM** that will encourage distorting, tax-sheltering activities (\$120 billion). *The Wall Street Journal* has said it "could be a very sweet deal for the nation's big, capital intensive companies.... It probably would spur the creation of a new generation of tax shelters. And it could allow some big and profitable companies to escape taxes altogether." (*WSJ*, 12/5/94, emphasis added).
3. **REPEAL OF THE CORPORATE ALTERNATIVE MINIMUM TAX**, designed to prevent major companies from paying no taxes (\$36 billion). A study has shown that prior to the 1986 reforms including the AMT, over half of the nation's largest and most profitable corporations paid no federal income tax in at least one full year, despite billions of dollars in U.S. profits. In one study, total U.S. profits for 130 corporations in their no-tax years were \$72.9 billion, yet their total federal income tax bill was actually negative \$6.1 billion. They received \$6.1 billion in refunds.
4. **CUTS IN THE GIFT AND ESTATE TAX** (\$23 billion), which would effectively increase the amount of gifts and transfers at death not subject to taxation from \$600,000 to \$750,000, and then index the exemption for inflation. **Individuals not making gifts or leaving inheritances over \$600,000 would not benefit from this provision.**

**THE JOINT COMMITTEE ON TAXATION HAS NOT ANALYZED THE DISTRIBUTIONAL EFFECTS OF THE CONTRACT'S CORPORATE TAX BREAKS.** The JCT analysis often cited by Republicans does not include corporate tax cuts--like neutral cost recovery and repeal of the AMT--which go overwhelmingly to the wealthy. Harvey Rosen, formerly the Bush Administration's top tax economist at Treasury and now head of the economics department at Princeton, has said, "Ignoring the corporate tax is clearly a loony thing to do." (*Wall Street Journal*, 3/23/95)

**EVEN WITHOUT THE CORPORATE TAX CUTS, THE JOINT COMMITTEE'S ANALYSIS SHOWS THAT THE CONTRACT TAX RELIEF OVERWHELMINGLY BENEFITS THE WEALTHY--WITH MORE BENEFITS FOR THE TOP 10% THAN THE BOTTOM 80%.** The JCT analysis excludes corporate taxes and makes other assumptions that lead to lower estimated benefits for high-income families. Even so, in the year 2000, the very same JCT analysis that Republicans continue to cite shows that the top 10% of taxpayers receive a bigger tax cut than the bottom 80%--\$22.7 billion versus \$21.6 billion in the year 2000.

**DRAFT****IF THE JCT INCLUDED THE CORPORATE TAX BREAKS, THEIR ANALYSIS WOULD MORE CLOSELY RESEMBLE TREASURY'S, WHICH SHOWS:**

- **51.5% of the Contract's benefits go to families making over \$100,000.**
- **The top 1% (1.1 million families making over \$350,000) get more tax benefits than the bottom 60%--over 65 million families.**
- **The average tax benefit for the top 1% is over \$20,000--over 75 times bigger than the average benefit for the 65 million families in the bottom 60% (\$267).**

**THE CHILD TAX CREDIT ONLY ACCOUNTS FOR 37% OF THE CONTRACT'S TAX CUTS.** Republicans sometimes use a pie chart showing the distribution of their child tax credit. But this credit--which is still fully available to those making up to \$200,000--is only one of fifteen different tax cuts in the Contract bill. **The child tax credit accounts for only 37% of the costs of the Contract tax bill over 10 years--less than the cost of the four tax breaks for the wealthy and big corporations listed above (Treasury estimates).**

**EVEN IF THE REPUBLICANS PHASE OUT THEIR CHILD TAX CREDIT BEGINNING AT \$95,000, MOST OF THE BENEFITS OF THEIR TAX BILL WOULD STILL GO TO FAMILIES WITH INCOMES OVER \$100,000.** The child tax credit has relatively little to do with the heavy targeting of high-income families in the Republican tax bill. The real problems are the other very large tax benefits like the AMT repeal and capital gains cut which disproportionately benefit high-income families.

**BECAUSE OF THE CORPORATE BREAKS, THE COSTS OF THE CONTRACT EXPLODE OVER 10 YEARS--WITH 72% OF THE TEN-YEAR COSTS IN THE SECOND FIVE YEARS.** While the costs of the Tax Relief Act over 5 years are \$178 billion, the costs over 10 years are \$630 billion (Treasury estimates). This means that 72% of the tax bill's costs are in the second 5 years--beyond the budget window. Even if the Republicans produce spending cuts to pay for the \$178 billion over 5 years--which they have not done--they still will not have paid for the exploding costs of their bill over time.

**Specifically, it is the corporate tax breaks whose costs explode in the second five years.** The new depreciation schedule provided for under "neutral cost recovery," for example, actually increases revenues in the first five years--the years for which Republicans now want to pay. But in the second five years, the costs of neutral cost recovery explode to nearly \$140 billion, making the total 10-year cost over \$120 billion.

**When JCT analyzed the costs of the tax cut over 10 years, they got similar results.** Republicans may claim that these Treasury estimates are somehow biased. The Joint Committee on Taxation has not scored the new Contract tax bill over 10 years. However, **when JCT scored the original (and very similar) provisions over 10 years, their cost estimate showed 72% of the costs in the second 5 years.** The JCT report also showed that neutral cost recovery would bring in \$16.7 billion in the first five years while costing \$105.3 billion in the second five years, producing an overall cost of \$88.6 billion. And, JCT showed that the child tax credit accounts for only about 40% of the total tax bill--an amount that has diminished with the removal of partial refundability.



ECONOMIC  
POLICY  
UPDATE

## Joint Economic Committee

March, 1995

U.S. SENATOR

Connie Mack

CHAIRMAN

ISSUED BY:

Connie Mack (FL), Chairman  
Jim Saxton (NJ), Vice Chairman  
Dick Armey (TX), House Majority Leader

### Class Warriors Claim Their First Victim: The Middle Class

For over a decade, the inaccurate criticism that family incomes fell during the Reagan years gained a certain currency in the press and among Democrats. A clear-headed look at the data, however, demonstrates not only that middle class families did well during the Reagan years, but that real family incomes have declined under President Clinton's policies of higher taxes and more regulation. This may be why these same critics appear uncomfortable as they try to explain the somewhat lackluster income record of the Clinton Administration.

*"... real family incomes have declined under President Clinton's policies of higher taxes and more regulation."*

For years the critics of Reagan policies used inaccurate Congressional Budget Office (CBO) family income data which led the media and the public to believe that middle class family income was falling during the 1980s, and that Reagan Administration policies were at fault. This political argument was factually false as Census Bureau data show that real middle class family income climbed 13 percent during the Reagan expansion years. Under the Clinton Administration's high tax and regulation policies, however, real family incomes declined 1.9 percent in President Clinton's first year alone.

After the critics had based their "fairness" issue on inaccurate CBO data, Census Bureau data released for 1993 show that, viewed from their own standpoint, the Clinton Administration presides over more unfairness than in any of the Reagan years; or indeed in any year in the postwar period. As a Joint Economic Committee (JEC/GOP) report<sup>1</sup> released by Representative Dick Armey suggested before the election, the fall in middle class income offers "a reason why a majority of Americans disapprove of Clinton Administration economic policies." It has nothing to do with public relations or "getting the message out," and everything to do with the decline of middle class income and earnings under Clinton.

#### Reich Test for Policy Supports Republican Initiatives

In a January 5, 1995, speech entitled "The Choice Ahead," Secretary of Labor Robert Reich sidesteps the Clinton Administration's failure to improve the economic position of the middle class by offering a disingenuous presentation of household income data using 1979 and 1993 as endpoints. In a partisan attack on Republican economic policies and in defense of the Clinton agenda, Reich ends his speech by setting this test for policy: "Which do you believe will make working families better off?"

Given that the Republican "Contract with America" was a key issue for both Republicans

*... continued*

and Democrats in the 1994 election, the American people have already provided their answer. Real median family income grew at a 1.7 percent average annual growth rate during the Reagan expansion years, compared to a 1.9 percent decline in real median family income during the first year of the Clinton presidency. If the income statistics of the last "decade and a half" provide any evidence for guiding policy, as Reich suggested, the one conclusion that can be drawn is that the only growth in median family income occurred when Reagan Administration policies were in effect.

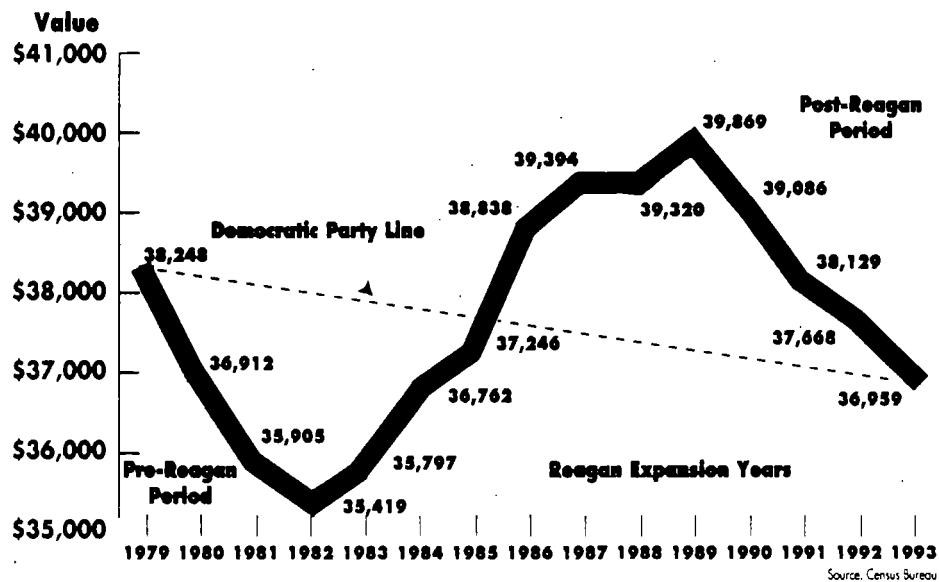
### Middle Class Family Income Rises During the Reagan Expansion Years

*"Real median family income increased 13% between 1982 and 1989."*

Real median family income increased 13 percent between 1982 and 1989, referred to as the Reagan expansion years. However, the 1979-82 period had been a severe setback for family income growth, with 1980 documented as one of the worst years on record. This explains why critics almost always include 1980, the last year of the Carter Administration, in the Reagan 1980s. While a proper demarcation point between the Carter and Reagan Administrations is debatable, even the most partisan Democrats should find it hard to argue that Reagan policies were bad enough to cause income declines the year previous to their passage. Implementation of Reagan income tax cuts began in the middle of 1982.

It also is misleading to say, as Reich did in his speech, that "for a decade and a half, ordinary families have been working harder and getting less." There simply hasn't been the long, gradual, downward trend in family income as the graph indicates. Partisan critics typically include the severe 1979-80 decline in family income under Carter in the Reagan years to flatten apparent income growth during the 1980s. Nonetheless, middle class income started falling late in the Carter years and rebounded during the Reagan years.

**Real Median Family Income Rises Under Reagan Policies**



In other words, the Reagan expansion years, which Democrats and the media have repeatedly disparaged as the most harmful to the middle class, were actually the one and only time that progress occurred in middle class family income over the last 15 years. It was not until after reversal of the low tax and de-regulatory policies adopted in the 1980s did middle class income start slipping again. In 1993, moreover, even as most other data showed economic expansion, it was remarkable to see a \$709 plunge in real median family income.

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Other Census data show that in 1993 real median earnings of full-time, year-round workers fell 2.2 percent for male workers and 1.2 percent for female workers. In fact, 1993 accounts for more than half of the decline in earnings experienced by males since 1989. Furthermore, real hourly earnings declined during 1994, and real median weekly earnings fell between the fourth quarter of 1993 and the fourth quarter of 1994.

### Who's the Unfairest of Them All?

*"... 1993 accounts for more than half of the decline in earnings experienced by males since 1989."*

According to the 1992 Clinton campaign, during the 1980s, "...the rich got richer, the forgotten middle class -- the people who work hard and play by the rules -- took it on the chin." The Clinton campaign also trumpeted the incorrect CBO data<sup>2</sup>, which was used by economist and then-Clinton ally Paul Krugman, in an attempt to show that the majority of income growth accrued to the top 1 percent. This was all reported in a March 5, 1992, *New York Times* article that contained other factual errors<sup>3</sup>. In his speeches, Secretary Reich has recently returned to this discredited methodology in arguing that 98 percent of the income growth since 1979 accrued to the top fifth of households. However, even using their discredited data source and methodology, this would appear to be an improvement relative to the Carter years when 100 percent of the income gains accrued to the top 1 percent.

*"... real hourly earnings declined during 1994."*

First of all, this approach is very misleading because of the fluctuation of income over the 1979-93 period. A more accurate description of the data is to say that the income gains during the Reagan expansion years in the four bottom quintiles were virtually wiped out by the income declines occurring in the bottom three quintiles during the other years in the 1979-93 period. Obviously, this pattern in the income data cannot support the argument that neo-Reagan policies will have a negative impact on middle class family or household income growth, as Secretary Reich suggests, since the data clearly point to the opposite conclusion. Furthermore, if Secretary Reich's accounting is accepted, then virtually 100 percent of the total income growth is attributed to the top fifth for the simple reason that his approach means that there is practically no other net income growth.

The Labor Secretary's interpretation is invalid also because at any range of income, the income of some families will be rising while that of others is falling regardless of changes in average income. In contrast to the bleak picture reflected in Census Bureau data for the Carter years, the average family income of all quintiles increased during the 1980s whether 1980, 1981, or 1982 is used as the base year. If the last year or two of the Carter Administration is used as the base year, this indeed changes the picture, but this has nothing to do with Reagan policy.

Second, and most importantly, Secretary Reich's whole exercise is essentially meaningless for the simple reason that none of the quintiles is composed of the same people over time. As has been stressed in a number of JEC/GOP studies, this way of misusing the income data fundamentally misrepresents the American economy by wrongly assuming that families or households are cemented into specific income strata for 10 years or more.

As shown in one JEC/GOP report<sup>4</sup>, there is actually a better chance that between 1979 and 1988 a household in the bottom fifth would move to the top fifth than remain in the bottom quintile (in this case defined as a tax filer). With well over 80 percent of this bottom fifth gone only nine years later, arguments such as Secretary Reich's have no relevance to this group. Their incomes have mostly gone up and are no longer in the caste that Secretary Reich has them assigned.

The same is generally true of the middle quintile. Nearly half of the middle fifth had

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moved to a higher strata by 1988, while only one-third remained. Furthermore, of households in the top 1 percent in 1979, over half had fallen to lower percentiles by 1988, replaced by others moving up from below. The argument that Americans are locked in economic strata is a caricature not rooted in reality.

*"... real median weekly earnings fell between the fourth quarter of 1993 and the fourth quarter of 1994."*

Third, Secretary Reich's argument is designed to mask the fact that, as pointed out earlier, the Reagan expansion years were actually a period of solid economic progress for the overwhelming majority of Americans. Far from being a period of setback for middle class families, the Reagan expansion years were the one and only improvement for them in the last 15 years. Secretary Reich neglected to mention this important statistical fact about median family income central to the main test he has raised with regard to Clinton Administration versus conservative Republican policies: "Which do you believe will make working families better off? This is the choice before us."

As reported by the Census Bureau, in 1993, the share of total household income in the bottom fifth, at 3.6 percent, was lower under President Clinton than in any Reagan year, and indeed lower than in any year in the postwar period. On the other hand, the share of income in the top 5 percent, at 20.0 percent, was higher under Clinton than in any Reagan year, or any year in the post-World War II period. Under this Administration, income dispersion has become the most unequal on record.

In short, the increase in inequality is larger under President Clinton than in any of the Reagan years. For those who view everything through the lens of redistributionism, the first Clinton year would have to be seen as much more unfair than any of the Reagan expansion years. From this perspective, the Clinton Administration should be viewed as the most unfair in the postwar period. Even after consideration of a number of caveats about the core data related to income mobility and data limitations, the Clinton record is a very shaky platform from which to attack others on the basis of "fairness."

### Conclusion

After years of partisan attacks immediately following the release of the annual Census Bureau data on family income, the class warriors were virtually silent following the 1993 income release. Upon reflection and judged on the same basis, the Democratic White House and Congress would have to be viewed as the unfairest of all, producing distributional results that far exceed even its worst caricatures of the allegedly unfair Reagan years. All this, and a decline in real middle class family income!

*"... real median family income fell in all the years chosen by Secretary Reich except the Reagan Expansion years."*

Secretary Reich's use of income data of the last 15 years as the basis of support for the Clinton agenda and opposition to renewed Reaganism is disingenuous. According to Reich's policy test, the evidence supports the argument that neo-Reagan policies would increase middle class real family income, and the alternatives depress real family income. That real median family income fell in all the years chosen by Secretary Reich except the Reagan expansion years compellingly refutes his arguments.

Christopher Frenze  
Majority Senior Economist

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#### End Notes:

<sup>1</sup> See JEC/GOP report, *Middle Class Income Declines in Clinton's First Year*, October 18, 1994.

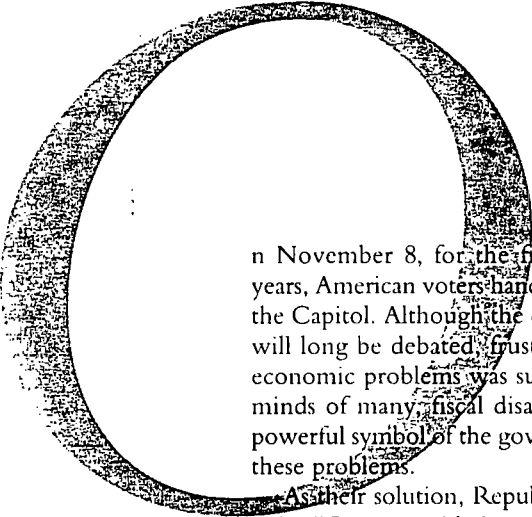
<sup>2</sup> See Republican Views of the 1994 Joint Economic Committee Annual Report.

<sup>3</sup> For example, even the correct number of families was misreported.

<sup>4</sup> See JEC/GOP report, *Income Mobility and Economic Opportunity*, June 1992.

# What's in Store?

DANIEL E. SICHEL



On November 8, for the first time in more than 40 years, American voters handed Republicans the keys to the Capitol. Although the causes of this dramatic shift will long be debated, frustration over long-standing economic problems was surely a key element. In the minds of many, fiscal disarray in Washington was a powerful symbol of the government's inability to solve these problems.

As their solution, Republicans offered voters a 10-point "Contract with America." And since the election they have quickly gone to work on the contract, important parts of which focus on how the government conducts its business: how it taxes, how it spends, and how it operates. In particular, the contract calls for tax cuts, deep spending cuts except for defense and Social Security, and a balanced budget by 2002.

Although the balanced budget amendment in the contract floundered and was defeated in the Senate over the issue of how to treat Social Security, the fiscal promises in the contract are likely to set the political agenda for some time to come. Senate Majority Leader Robert Dole has vowed to bring the balanced budget amendment up again later this year, and pressure to reduce the deficit is unlikely to diminish. Moreover, the balanced budget amendment was just a promise to balance the budget. Congress can still pursue a fiscal path leading to budget balance by 2002, even without a constitutional amendment in force.

Thus, the fiscal promises in the contract are still front and center. And the key question remains: what must happen between now and 2002 to balance the budget and fulfill the other fiscal promises in the contract? But before looking ahead, it is helpful to look back a bit.

## How Did We Get into the Deficit Mess?

Large budget deficits in peacetime are a relatively new feature on the U.S. economic landscape. By and large, deficits were small before the 1980s, except during wars and recessions. But in the early 1980s, the nation spun the fiscal roulette wheel: taxes were cut and defense spending raised without substantial spending cuts in other areas. At the time, the hope was that these changes would not boost the deficit because tax cuts

would actually boost revenues. But the nation lost that fiscal gamble, and the government's budget deficit soared. As each year's hefty deficit was added on to those of past years, the total debt of the federal government surged upward as well.

Figure 1 shows the ratio of total federal debt to gross domestic product (GDP) since the end of World War II. Following heavy wartime deficit spending, the ratio fell rapidly through the early 1970s and was roughly stable over the next decade. If the diagram ended in 1980, one would not conclude that the federal household was mismanaged. On the contrary, the record until then showed that small deficits and robust economic growth had combined to cause the debt to shrink as a share of GDP. This point bears emphasis. The deficit problem is not age-old. It was created by the policy mistakes of the early 1980s. At that time, large budget deficits pushed the total stock of debt up much faster than the economy, and the ratio turned back up, reaching 70 percent by 1995.

Recent years have seen some progress on reducing the deficit and therefore slowing the rate at which total debt is growing. The deficit reduction agreements of 1990 and 1993 helped bring a 1992 deficit of \$290 billion down to an estimated \$176 billion by 1995. But the Congressional Budget Office (CBO) now projects that the deficit will rise to \$320 billion by 2002, the year the contract promises a balanced budget.

Large deficits do not cause immediate harm to the economy. Rather, they eat away at its foundations. Saving and investment are key to future economic growth. Given the already low private saving rate in the United States, large deficits—or dissaving by the government—leave even less saving for other productive investments. Over extended periods, reduced investment implies less capital per worker and the gradual buildup of losses in labor productivity and wages. Of course, investments in the United States can be financed by borrowing overseas, but if foreigners help foot the bill—as they did during the 1980s—then they receive many of the benefits. Most economists agree that getting the deficit down would significantly improve the nation's long-run economic health.

# The GOP Contract for Tax Cuts and a Balanced Budget

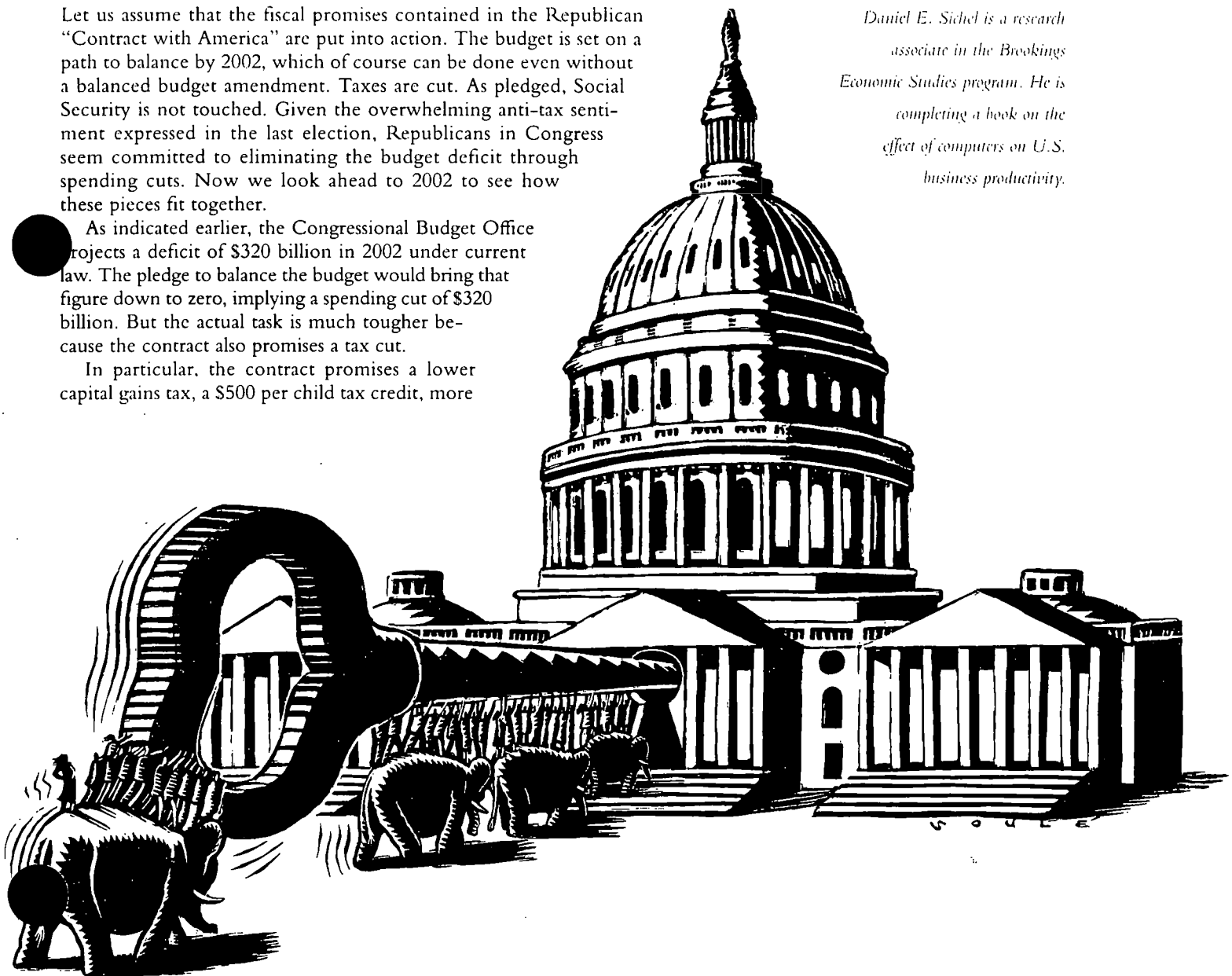
## How Does the Contract with America Address These Problems?

Let us assume that the fiscal promises contained in the Republican "Contract with America" are put into action. The budget is set on a path to balance by 2002, which of course can be done even without a balanced budget amendment. Taxes are cut. As pledged, Social Security is not touched. Given the overwhelming anti-tax sentiment expressed in the last election, Republicans in Congress seem committed to eliminating the budget deficit through spending cuts. Now we look ahead to 2002 to see how these pieces fit together.

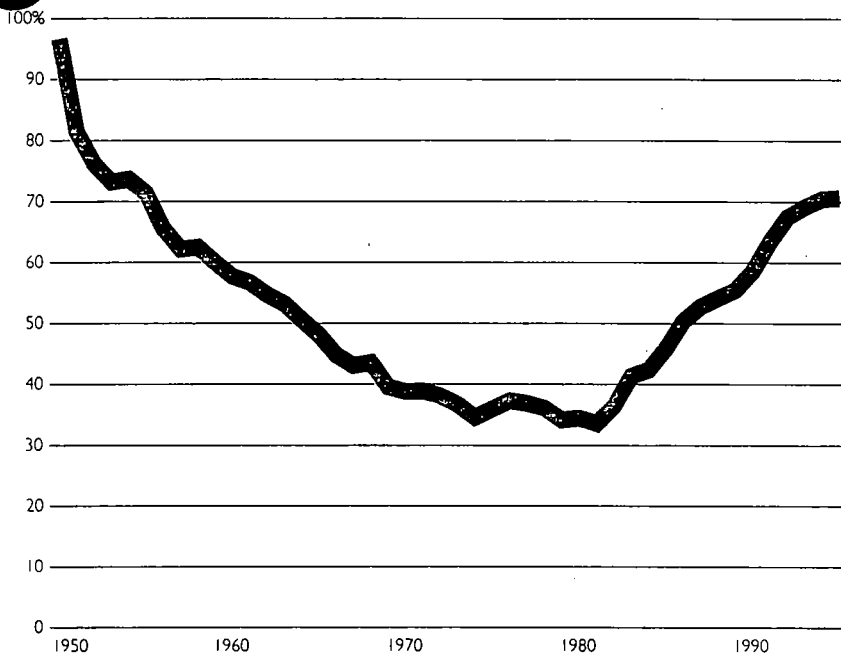
As indicated earlier, the Congressional Budget Office projects a deficit of \$320 billion in 2002 under current law. The pledge to balance the budget would bring that figure down to zero, implying a spending cut of \$320 billion. But the actual task is much tougher because the contract also promises a tax cut.

In particular, the contract promises a lower capital gains tax, a \$500 per child tax credit, more

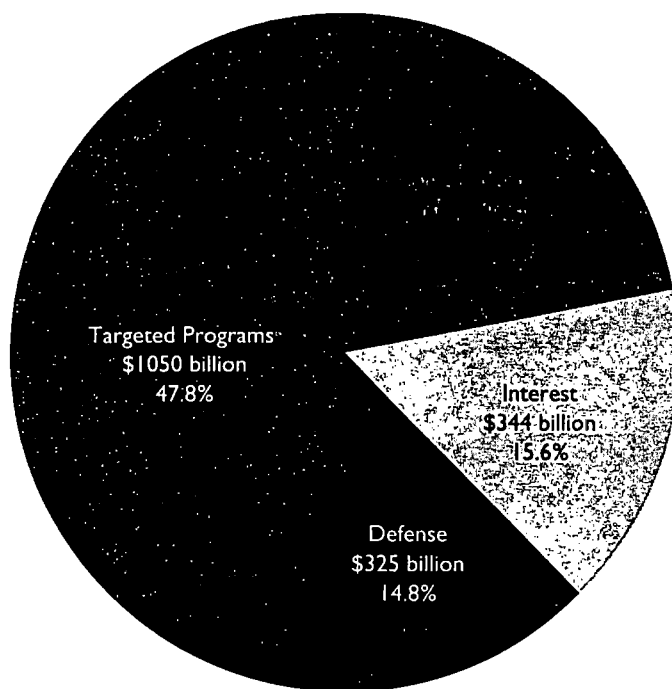
*Daniel E. Sichel is a research associate in the Brookings Economic Studies program. He is completing a book on the effect of computers on U.S. business productivity.*



**Figure 1. Federal Debt As a Share of GDP**



**Figure 2. Projected Spending Shares, 2002**



generous depreciation rules for businesses, and a cut in taxes paid by Social Security recipients. For this budget exercise, we will assume that all those tax provisions are enacted. Last December, the U.S. Treasury estimated that the cost of those tax cuts would average \$40 billion a year over the first five years, surging to more than \$100 billion a year for the next five. In 2002, the estimated revenue loss equals \$100 billion. The tax cuts make balancing the budget in 2002 even harder, because \$100 billion of spending must be cut just to stay even.

Thus, balancing the budget while paying for very expensive tax cuts means that \$420 billion must be cut from projected spending in 2002. If the budget cutters set to work at once, rather than waiting until 2002, the debt on which interest must be paid would be lower over the next seven years and interest rates might be lower too, possibly saving as much as \$100 billion in interest payments by 2002. Thus, the Republicans must find roughly \$320 billion in annual programmatic cuts in 2002. (In subsequent years, the challenge is even more difficult for two reasons. First, CBO projects that under current law the deficit will rise even further by 2005, pushed up by rising health care costs. Second, the revenue loss from the tax cuts in the contract explodes in later years.)

Such a cut would be difficult enough if it came out of all programs. However, the contract shields Social Security and defense from the budget knife. Figure 2 highlights the significance of this exclusion, showing CBO's projected spending shares for 2002 under current law. Social Security, defense, and interest payments on the debt account for more than half of all federal outlays, a crucial but often overlooked point. Because the contract promises to exclude these programs, the entire \$320 billion cut in programs must come from the much diminished "targeted spending" category, implying a reduction of more than 30 percent.

Table 1 emphasizes the ramifications of placing a big chunk of spending off limits for cuts. The top line shows projected spending in 2002 for all programs except interest and shows the spending cut of \$320 billion required to balance the budget under the promises of the contract. As the table shows, the excluded programs—Social Security and defense—are not to be touched, and therefore the targeted programs must be cut by almost one-third.

Within the targeted programs, the ultimate distribution of hits remains to be determined. Nevertheless, an examination of the components of the targeted spending category reveals who stands to lose under the contract, and who, therefore, might be expected to oppose the budget cuts. As the table shows, grants to cities and states account for about a quarter of the targeted spending category. These grants cover highway construction, support for education, health programs including Medicaid, disaster relief, and a host of other activities.

According to a recent Treasury Department study, some large states could be big losers if Social Security and defense are exempt from cuts and all programs in "targeted spending" are cut by nearly a third. For example, California—whose Republican governor Pete Wilson has been mentioned as a presidential hopeful—stands to lose as much as \$10.5 billion by 2002.

New York, whose newly elected Republican governor George Pataki has promised a large tax cut, would lose a similar amount; making up this lost revenue would require a state tax hike of more than 20 percent or substantial cuts in services. Governors and mayors may go to the chopping block quietly.

Retirees also receive a big chunk of targeted spending, with Medicare and pensions (civilian and military) accounting for about 40 percent of the targeted category. Because retirees are a powerful political constituency, their programs may be spared the full force of the budget ax, but then, of course, the cuts in other programs would have to be that much greater.

Everything else in targeted spending is projected to cost \$350 billion under current law. If painful choices elsewhere make this category the chief target of the budget cutters, spending would be virtually eliminated for such programs as federal prisons, the federal court system, the National Weather Service, NASA, cancer research, the National Parks, and most other federal government activities.

Figure 3 provides another perspective on the challenge facing budget cutters, highlighting the source of pressure on federal spending. This figure charts shares of federal spending back to 1965, broken down a little differently than in the pie charts. Social Security, defense, and interest payments have accounted for more than half of federal outlays for many years. The share of spending for Medicare and Medicaid has risen rapidly since 1970, pushed up, in large part, by the steep ascent in health care costs, which has also affected the private sector. Unless a way is found to offset price increases for health care, either recipients of government health care must pay more, access to government-financed care must be limited, or health care costs will continue to put pressure on the budget. The category of spending labeled "other"—outlays less Social Security, defense, interest, Medicare, and Medicaid—has actually been on a downtrend as a share of output since around 1980, a fact that may come as a surprise to those subjected to the drumbeat of rhetoric about government programs eating up more and more of the economy's resources.

### Other Roads to a Balanced Budget

According to this budget arithmetic, it will be next to impossible to balance the budget if Social Security and defense are exempt from cuts and future tax hikes are ruled out. Some contend, however, that traditional budget arithmetic is the wrong way to frame the issue. Either they argue that the use of baseline spending assumptions makes budget balance look harder to achieve than it really is. Or they contend that this budget arithmetic implicitly—and wrongly—assumes a continuation of the current structure of federal spending. Does either critique offer an alternative road to budget balance?

### Holding the Line on Current Spending

The budget analysis summarized in the pie and bar charts, necessary spending cuts are calculated relative to a baseline budget, which itself is growing over time to take account of increases in population and

inflation. Critics argue that if spending could just be frozen at current levels, then the budget would be in balance by the end of the century. This line of reasoning is correct in principle, but difficult in practice because most of the projected increases in spending are for interest payments on the debt and entitlements that will be politically painful to cut.

For example, spending for Social Security is projected to rise about 5 percent a year in nominal terms because the number of retirees increases and because benefits are indexed to inflation. If spending on Social Security were frozen at 1995 levels, benefits in 2002 would be more than 30 percent lower than they would be if every recipient received the benefit promised under current law. Even if Social Security were allowed to increase at 3 percent a year to cover inflation, benefits in 2002 would still be 14 percent below what current law promises.

Similarly, outlays for Medicare are expected to increase more than 10 percent a year. Just as for Social Security, the number of retirees on Medicare is expanding. And rapid increases in the price of medical care, accompanied by ever wider use of new technologies, push up anticipated spending quite rapidly. Even if increases in Medicare outlays were held to only 3 percent, benefits in 2002 would have to be cut by more than a third relative to what recipients would receive under current law. Medical services received by retirees would necessarily be cut back.

Simple formulas for achieving budget balance—such as holding current spending constant—entail extremely hard political choices.

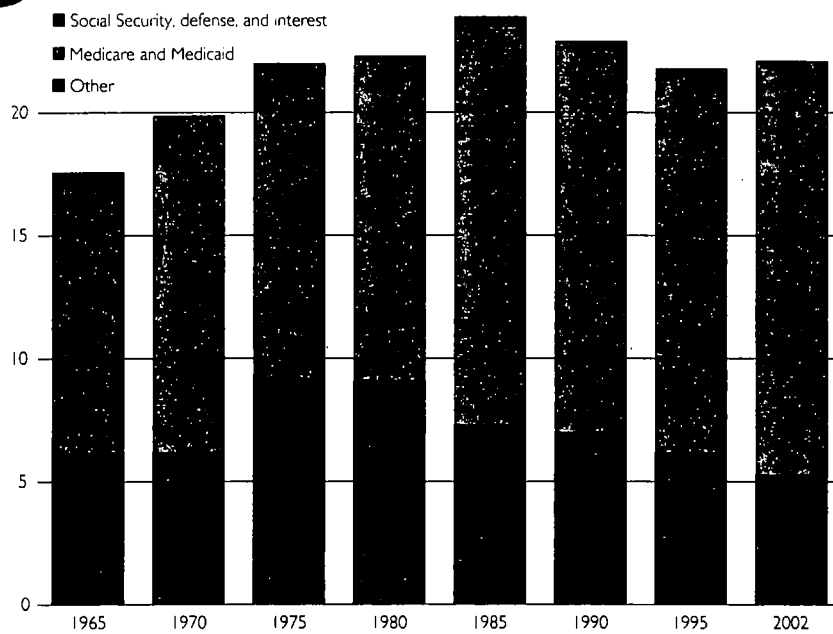
### Taking a Chain Saw to Federal Spending

The other frequent criticism of conventional budget analysis is that trimming around the edges of the current structure of federal spending will never work; solving the deficit problem requires taking a chain saw to entire programs. Consider estimated savings from the following list of programs sometimes mentioned as candidates for cuts.

Completely eliminating federal payments for Aid to Families with Dependent Children—the government's main welfare program providing cash benefits for the poor—would save an estimated \$16.4 billion a year by the end of the decade. Zeroing out farm subsidy programs would save \$10.8 billion a year. Stopping subsidies for urban mass transit would hold down yearly spending by \$4.8 billion. Defunding the space station would save another \$2.4 billion. Shutting down the Small Business Administration would save \$550 million (yes, less than \$1 billion). Eliminating federal support of Amtrak would save another \$800 million or so. Switching off the subsidies received by the Rural Electrification Administration would keep spending down by another \$90 million. At this point, a lot of political blood would have been spilled and the deficit would be down by only \$36 billion, a long way from the hundreds of billions in spending cuts needed to balance the budget.

Should spending be carefully examined to eliminate fat? Yes. Will that balance the budget? No. The lesson of budget arithmetic is simple. Although spending can

**Figure 3. Federal Spending as a Share of GDP**



**Table 1. Required Spending Cuts in 2002 under the Contract**

(billions of dollars, except where noted)

	CBO PROJECTIONS UNDER CURRENT LAW	CUT REQUIRED UNDER CONTRACT	PERCENT CUT REQUIRED UNDER CONTRACT
Spending for programs (excluding interest)	\$1856	\$320	—
Excluded programs	806	0	0%
Social Security	481	0	0%
Defense	325	0	0%
Targeted programs	1050	320	30%
Cities and states*	265	?	?
Retirees†	435	?	?
Everything else	350	?	?

Source: CBO, Treasury, and author's calculations.

\* Medicaid and other grants.

† Medicare, civilian, and military pensions.

be cut and efficiency improved in many areas, balancing the budget will be virtually impossible without touching the big programs like Social Security, Medicare, and defense. Back in the 1930s Willie Sutton explained that he robbed banks because that's where the money is. If Willie were a member of the House or Senate Budget Committee today, he would be looking up addresses for these large programs.

**What Happens Once the Budget Is Balanced?**

The difficulty of balancing the budget, of course, is what led many in Congress to support a constitutional amendment to force the tough choices. But while getting the deficit down would be a definite plus for the economy's long-term health, doing so by amending the Constitution has some disadvantages. The likelihood that the issue will arise again despite its recent defeat in the Senate makes it important to keep four, in particular, in mind.

First, a balanced budget amendment could turn a mild economic slowdown into a major recession, because fiscal policy will lose its ability to stabilize the economy automatically. As jobs are lost and incomes fall during a slowdown, tax revenues will decline. As more jobless workers apply for unemployment insurance and other benefits, spending will rise. Falling revenues and higher spending could generate a very large temporary deficit. Under the old rules, such deficit spending would automatically boost the weakened economy. But under the new rules, the budget must be balanced. Congress would have to slash spending or raise taxes, either of which would push the economy deeper into recession. And the negative effects of a downturn can linger for a long time, as they did after the most recent recession, which officially ended in the spring of 1991.

But in the amendment just considered by Congress, a three-fifths majority of the House and Senate could waive the budget balance requirements. And often they surely would. But given the uncertainties of economic forecasting, would Congress always act before serious economic damage was done? Would a determined minority in either house ever block a move to waive the budget rules in time of economic crisis, perhaps to delay recovery and weaken the election prospects of the president? Such damage to the nation's economy could all be done in the name of defending the Constitution.

Second, requiring year-to-year budget balance would hold Washington to an extreme standard. Although it is often said that the federal government should balance its budget just as families do, most households do not. Few families pay cash to buy homes, cars, and college educations; they borrow. Businesses borrow to finance inventories or invest in plant and equipment. States issue bonds (borrow) to finance capital expenditures like highways. Year-to-year budget balance would require that the federal government's purchases of long-term capital (buildings, highways, defense equipment) be paid for in full in the year of purchase, a very peculiar accounting standard.

Third, a balanced budget amendment could lead to increasingly outlandish budget shenanigans. Many tools are available to Congress besides direct spending.

Congress could declare certain government expenses to be off-budget. It could impose requirements on state and local governments or on the private sector, perhaps with off-budget loan guarantees to sweeten the pot. Such maneuvers would further undermine the budget process, dragging the debate even deeper into procedural muck and creating even more voter cynicism.

Fourth, a balanced budget amendment raises difficult enforcement questions. Suppose spending exceeds revenue in 2004? Would the federal courts enforce the balanced budget amendment? Would they raise income taxes? cut Social Security benefits? Would they, as Bill Frenzel, a former Republican Congressman now at Brookings, puts it, "send the U.S. marshals in to arrest the check writers?" Whatever the case, Congress and the president would have ceded much of their authority to unelected judges. Suppose instead that the amendment is simply ignored or sidestepped with creative accounting, something like Prohibition earlier this century. Although such a move might ease a temporary budget crisis, it would damage respect for the rule of law and voters' confidence in their government.

#### **A Challenge Unmet**

The fundamental economic challenges facing the nation, including sluggish growth in real wages and productivity for today's workers, diminished economic prospects for our children and grandchildren, and a further falling behind of those at the bottom of the income distribution, go well beyond the budget deficit. Any solution to these problems will require greater investments in our future, and deficit reduction—which frees up the nation's savings for productive investment—is surely a step in the right direction.

But the "Contract with America" may not move us in that direction. It does not specify how the budget would be balanced, and once Social Security and defense are taken off the cutting table and future tax hikes are ruled out, budget balance will be extremely difficult to achieve. And tax cuts today—unless paid for by spending cuts or tax hikes elsewhere—only make it harder to balance the budget.

Nevertheless, most Americans support the concept of a balanced budget amendment. A January 12 *Wall Street Journal* opinion poll showed approval at almost 70 percent. Americans do not, however, support the painful deficit reduction that the analysis here shows will be necessary to actually balance the budget. The same opinion poll finds that 60 percent of Americans oppose the amendment if it entails substantial cuts in entitlement programs such as Medicare, Medicaid, and veterans' benefits.

The contract perfectly mirrors this inconsistency in public opinion, promising budget balance without pain. Its failure to come to grips with budget arithmetic perpetuates the myth that the nation's fiscal problems can be solved without sacrifice by most Americans. The contract's supporters, Republicans and Democrats alike, are merely deferring the political debate we must one day have over how to get the deficit down and how to improve the nation's long-run economic prospects. ■

*The fundamental economic challenges facing the nation, including sluggish growth in real wages and productivity for today's workers, diminished economic prospects for our children and grandchildren, and a further falling behind of those at the bottom of the income distribution, go well beyond the budget deficit.*

**DESCRIPTION OF THE  
"CONTRACT WITH AMERICA TAX RELIEF ACT OF 1995"**

**Scheduled for Markup**

**by the**

**HOUSE COMMITTEE ON WAYS AND MEANS**

**Beginning on March 14, 1995**

**Prepared by the Staff**

**of the**

**JOINT COMMITTEE ON TAXATION**

**March 9, 1995**

**JCX-9-95★**

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## INTRODUCTION

This document,<sup>1</sup> prepared by the staff of the Joint Committee on Taxation, provides a description of the "Contract With America Tax Relief Act of 1995." The House Committee on Ways and Means has scheduled a markup of these provisions beginning on March 14, 1995. The "Contract With America Tax Relief Act of 1995" includes provisions derived from the revenue provisions contained in the "Contract With America" (the "Contract"), as well as certain other revenue proposals.

The Contract was signed by over 300 Republican House candidates and incumbents on September 27, 1994, as an agenda for the first 100 days of the 104th Congress. The Contract was introduced when the 104th Congress convened on January 4, 1995, and includes four bills that contain various tax proposals: H.R. 6 ("American Dream Restoration Act"), H.R. 8 ("Senior Citizens' Equity Act"); H.R. 9 ("Job Creation and Wage Enhancement Act"); and H.R. 11 ("Family Reinforcement Act").

Part I of this document describes tax provisions derived from the American Dream Restoration Act. Part II contains a description of tax provisions derived from the Senior Citizens' Equity Act. Part III describes tax provisions derived from the Job Creation and Wage Enhancement Act, with additional proposals regarding a 25-percent corporate alternative tax for capital gains, the treatment of leasehold improvements, and the alternative minimum tax. Part IV of this document contains a description of tax provisions derived from the Family Reinforcement Act; Part V describes a proposal to increase the social security earnings limit derived from the Senior Citizens' Equity Act; and Part VI relates to the provisions of H.R. 1121, the "Tax Technical Corrections Act of 1995," introduced on March 3, 1995 with certain modifications.

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<sup>1</sup> This document may be cited as follows: Joint Committee on Taxation, *Description of the "Contract With America Tax Relief Act of 1995"* (JCX-9-95), March 9, 1995.

## DESCRIPTION OF PROVISIONS

### I. THE AMERICAN DREAM RESTORATION TAX ACT (TITLE I)

#### A. Family Tax Credit

##### Present Law

Present law does not provide tax credits based solely on the number of dependent children. Taxpayers with dependent children, however, generally are able to claim a personal exemption for each of these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is \$2,500 for 1995, and is adjusted annually for inflation. The amount of the personal exemption is phased out for taxpayers with AGI in excess of \$114,700 for single taxpayers, \$143,350 for heads of household, and \$172,050 for married couples filing joint returns.

In addition, eligible low-income workers are able to claim a refundable earned income tax credit (EITC). The amount of the credit an eligible taxpayer may claim depends upon whether the taxpayer has one, more than one, or no qualifying children, and is determined by multiplying the credit rate by the taxpayer's earned income up to an earned income threshold. The maximum amount of the credit is the product of the credit rate and the earned income threshold. In 1995, the maximum credit is \$3,112 for taxpayers with more than one qualifying child, \$2,093 for taxpayers with one qualifying child, and \$314 for taxpayers with no qualifying children. For taxpayers with earned income (or AGI, if greater) in excess of the phaseout threshold, the credit amount is reduced by the phaseout rate multiplied by the amount of earned income (or AGI, if greater) in excess of the phaseout threshold. The credit is not allowed if earned income (or AGI, if greater) exceeds the phaseout limit. In 1995, the phaseout limit is \$26,676 for taxpayers with more than one qualifying child, \$24,388 for taxpayers with one qualifying child, and \$9,234 for taxpayers with no qualifying children.

##### Description of Provision

The provision would provide taxpayers with a maximum nonrefundable tax credit of \$500 for each qualifying child.

The credit would be phased out ratably for taxpayers with AGI over \$200,000, and would be fully phased out at AGI of \$250,000. For purposes of this AGI test, the taxpayer's AGI would be increased by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands; and residents of Puerto Rico, respectively). In calendar years beginning after 1996, the maximum credit amount (\$500) and the beginning point of the phaseout range (\$200,000) would be indexed annually for inflation with rounding to the nearest \$50. The size of the phaseout range would change as needed so as to remain 100 times the maximum

amount of the credit per child.

To be a qualifying child, an individual would have to satisfy a relationship test, a dependency test, and an age test. An individual would satisfy the relationship test if the individual is a son or daughter of the taxpayer, a descendant of a son or daughter of the taxpayer, a stepson or stepdaughter of the taxpayer, or a foster or adopted child of the taxpayer. A foster child would have to, for the taxable year of the taxpayer, (1) be a member of the taxpayer's household and (2) have as his principal place of abode the home of the taxpayer. An adopted child would include a child who is legally adopted or who is placed with the taxpayer by an authorized placement agency for adoption by the taxpayer.

An individual would satisfy the dependency test if the individual is a dependent of the taxpayer with respect to whom the taxpayer is entitled to claim a dependency deduction. For purposes of the above test, the term "dependent" would not include an individual who is a resident of a country contiguous to the United States unless that individual is an adopted child of a taxpayer who is a U.S. citizen or national and, for the taxpayer's taxable year, the individual is a member of the taxpayer's household and has as his principal place of abode the home of the taxpayer.

An individual would satisfy the age test if the individual has not attained the age of 18 as of the close of the calendar year in which the taxable year of the taxpayer begins.

The provision would provide that couples who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the qualifying child for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year.

Except in the case of a taxable year closed by reason of the taxpayer's death, no credit would be allowable in the case of a taxable year covering a period of less than 12 months.

#### **Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## **B. Credit to Reduce the Marriage Penalty**

### **Present Law**

A married couple generally is treated as one tax unit that must pay tax on the unit's total taxable income. Although married couples may elect to file separate returns, the rate schedules and provisions are structured so that filing separate returns usually results in a higher tax than filing joint returns. Other rate schedules apply to single persons and to single heads of household.

A "marriage penalty" exists when the sum of the tax liabilities of two unmarried individuals filing their own tax returns (either single or head of household returns) is less than their tax liability under a joint return (if the two individuals were to marry). A "marriage bonus" exists when the sum of the tax liabilities of the individuals is greater than their combined tax liability under a joint return.

While the size of any marriage penalty or bonus under present law depends upon the individuals' incomes, number of dependents, and itemized deductions, as a general rule married couples whose earnings are split more evenly than 70-30 suffer a marriage penalty. Married couples whose earnings are largely attributable to one spouse generally receive a marriage bonus.

Under present law, the size of the standard deduction and the bracket breakpoints follow certain customary ratios across filing statuses. The standard deduction and bracket breakpoints for single filers are roughly 60 percent of those for joint filers. The standard deduction and bracket breakpoints for head of household filers are about 83 percent of those for joint filers. With these ratios, unmarried individuals have standard deductions whose sum exceeds the standard deduction they would receive as a married couple filing a joint return. Thus, their taxable income as joint filers may exceed the sum of their taxable incomes as unmarried individuals. Furthermore, because of the way the bracket breakpoints are structured, as joint filers they may have some of their taxable income pushed into a higher marginal tax bracket than when they were not married.

The rate changes in the Revenue Reconciliation Act of 1993 exacerbated the existing marriage penalty because the new bracket breakpoints did not provide the customary ratios across filing statuses. For the new 36-percent bracket, the breakpoint for single filers and for head of household filers are 82 percent and 91 percent, respectively, of the breakpoint for joint filers. For the 39.6-percent bracket that results from the "surtax," the bracket breakpoint is \$250,000 regardless of filing status.

### **Description of Provision**

Married couples who file a joint return could be eligible for a nonrefundable credit against their income tax liability. The amount of the credit would be determined based on the earned income of each of the spouses. The Secretary of the Treasury would issue tables calculating the marriage penalty credit applicable for married taxpayers based on the earned incomes of the spouses.

The amount of the credit would be based on the hypothetical tax liabilities that would result if the individual income tax rates applicable to single filers were applied to each spouse's earned income, allowing for one personal exemption and the standard deduction allowed for single filers. The sum of those hypothetical tax liabilities would be compared to the hypothetical tax liability that would result if the individual income tax rates applicable to married couples filing joint returns were applied to the aggregate earned income of the spouses, allowing for two personal exemptions and the standard deduction allowed for joint filers.

If the hypothetical tax liability of the married couple exceeds the sum of the hypothetical tax liabilities of the individual spouses, the married couple would be allowed a nonrefundable tax credit equal to the lesser of that excess or \$145, with amounts less than the maximum credit rounded to the nearest \$25. If the hypothetical tax liability of the married couple is less than or equal to the sum of the hypothetical tax liabilities of the individual spouses, the married couple would not be allowed the credit.

#### **Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## **C. American Dream Savings Accounts and Deductible Spousal IRAs**

### **Present Law**

Under present law, an individual may make deductible contributions to an individual retirement arrangement (IRA) up to the lesser of \$2,000 or the individual's compensation if the individual is not an active participant in an employer-sponsored retirement plan (and, if married, the individual's spouse also is not an active participant in such a plan). In addition, the \$2,000 limit is increased to \$2,250 in the case of a married taxpayer who files a joint return and makes contributions to an IRA for the benefit of his or her spouse, if the spouse has no compensation or elects to be treated as having no compensation. The \$2,250 contribution can be divided in any manner between IRAs for each spouse, except that the maximum contribution to an IRA on behalf of one individual cannot exceed \$2,000.

If the individual (or the individual's spouse) is an active participant in an employer-sponsored retirement plan, the \$2,000 deduction limit (and the \$2,250 spousal IRA deduction limit) is phased out over certain adjusted gross income (AGI) levels. The limit is phased out between \$40,000 and \$50,000 of AGI for married taxpayers, and between \$25,000 and \$35,000 of AGI for single taxpayers. An individual may make nondeductible IRA contributions to the extent the individual is not permitted to make deductible IRA contributions. Contributions cannot be made to an IRA after age 70-1/2.

The amounts held in an IRA, including earnings on contributions, generally are not subject to tax until withdrawn. Amounts withdrawn prior to attainment of age 59-1/2 are subject to an additional 10-percent early withdrawal tax, unless the withdrawal is due to death, disability, or is made in the form of certain periodic payments. A similar early withdrawal tax applies to distributions from tax-qualified pension plans, with an additional exception for distributions used to pay medical expenses that exceed 7.5 percent of AGI. This exception for distributions to pay extraordinary medical expenses does not apply to withdrawals from IRAs.

In general, distributions from an IRA are required to begin at age 70-1/2. An excise tax is imposed if the minimum required distributions are not made. Distributions to the beneficiary of an IRA are generally required to begin within 5 years of the death of the IRA owner, unless the beneficiary is the surviving spouse. Similar rules apply to distributions from tax-qualified pension plans.

Present law imposes a 15-percent excise tax on excess distributions with respect to an individual during any calendar year from qualified retirement plans, tax-sheltered annuities, and IRAs. The purpose of the tax is to limit the total amount that can be accumulated on behalf of a particular individual on a tax-favored basis. In general, excess distributions are defined as the aggregate amount of retirement distributions (i.e., payments from applicable retirement plans) made with respect to an individual during any calendar year to the extent such amounts exceed \$150,000 (for 1995). The

dollar limit is indexed for inflation. Special rules apply in the case of lump-sum distributions and post-death distributions.

### **Description of Provision**

#### **Tax-free nondeductible IRAs**

The provision would replace present-law nondeductible IRAs with new American Dream Savings accounts ("ADS accounts") to which individuals could make nondeductible contributions. Contributions to an ADS account would be in addition to any contributions that can be made to a deductible IRA under the present-law rules. An ADS account would be an IRA which is designated at the time of establishment as an ADS account in the manner prescribed by the Secretary. Qualified distributions from an ADS account would not be includible in income.

The maximum annual contribution that could be made to an ADS account would be the lesser of \$2,000 or the individual's compensation for the year. In the case of a married couple, the aggregate compensation of the couple would be taken into account in determining the maximum permitted contribution. Thus, for example, in 1996 each spouse in a married couple could make an ADS contribution of \$2,000 (for a total contribution by the couple of \$4,000), provided the couple has at least \$4,000 in compensation. The \$2,000 contribution limit would be adjusted annually for inflation beginning after 1996. Inflation adjustments would be rounded to the nearest \$50.

Contributions to an ADS account could be made even after the individual for whom the account is maintained has attained age 70-1/2. The pre-death minimum distribution rules that apply to IRAs would not apply to ADS accounts, and amounts in ADS accounts would not be taken into account for purposes of the excise tax on excess distributions.

Qualified distributions from an ADS account would not be includible in gross income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution would be a distribution that is made after the 5-taxable year period<sup>2</sup> beginning with the first taxable year in which the individual made a contribution to an ADS account, and (2) which is (a) made on or after the date on which the individual attains age 59-1/2, (b) made to a beneficiary (or to the individual's estate) on or after the death of the individual, (c) attributable to the individual's being disabled, or (d) a qualified special purpose distribution.

Qualified special purpose distributions (whether or not qualified distributions) would not be

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<sup>2</sup> In the case of rollover contributions that are not from another ADS account, the 5-year holding period would begin on the date on which the rollover was made. As is the case with IRAs generally, contributions to an ADS account could be made for a year by the due date for the individual's tax return for the year (determined without regard to extensions). The 5-year holding period would run from the taxable year in which the individual is deemed to make the contribution.

subject to the 10-percent tax on early withdrawals. Distributions from an ADS account other than qualified distributions or qualified special purpose distributions would be includible in gross income and subject to the 10-percent tax on early withdrawals.

In general, qualified special purpose distributions would be distributions: for the purchase or acquisition of a principal residence of a first-time homebuyer; for qualified higher education expenses; for medical expenses of the taxpayer or the taxpayer's spouse and dependents; or for long-term care insurance premiums treated as medical expenses under the long-term care provisions.

First-time homebuyers would be individuals who did not own an interest in a principal residence during the 3 years prior to the purchase of a home. In order to qualify as a first-time homebuyer distribution, the distribution would have to be used within 60 days to pay the costs of acquiring, contracting, or reconstructing a residence. If there is a delay in acquisition, construction, or reconstruction, the distribution could be redeposited in an ADS account within 120 days without imposition of tax.

Qualified higher education expenses would be tuition, fees, books, supplies and equipment required for the enrollment or attendance of the taxpayer, the taxpayer's spouse, or a child or grandchild of the taxpayer at an eligible educational institution (defined as under sec. 135). The amount of qualified higher education expenses would be reduced by any amount excludable from income under the present-law rules relating to education savings bonds (sec. 135).

Distributions from ADS accounts could be rolled over tax free to another ADS account. In addition, amounts withdrawn from an IRA could be rolled over to an ADS account after December 31, 1995, and before January 1, 1998. The amount otherwise includible in gross income due to the IRA distribution would be included in gross income ratably over the 4-taxable year period beginning with the taxable year in which the distribution is made. The early withdrawal tax would not apply to such rollovers.

### **Deductible contributions to spousal IRAs**

The provision would modify the present-law rules relating to deductible IRAs by permitting deductible IRA contributions of up to \$2,000 to be made for each spouse (including, for example, a home maker who does not work outside the home) if the combined compensation of both spouses is at least equal to the contributed amount. The provision would not otherwise modify the rules relating to deductible IRAs.

### **Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## II. SENIOR CITIZENS' EQUITY TAX ACT (TITLE II)

### A. Repeal of Increase in Income Tax on Social Security Benefits

#### Present Law

##### In general

Under present law, taxpayers receiving Social Security and Railroad Retirement Tier 1 benefits are not required to include any such benefits in gross income if their "provisional income" does not exceed \$25,000 in the case of unmarried taxpayers or \$32,000 in the case of married taxpayers filing joint returns. For purposes of these computations, a taxpayer's provisional income is defined as adjusted gross income plus tax-exempt interest plus certain foreign source income plus one-half of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit.

Certain taxpayers with provisional income in excess of those thresholds are required to include in gross income up to 50 percent of their Social Security or Railroad Retirement Tier 1 benefit. Under a provision added by the Revenue Reconciliation Act of 1993 ("1993 Act"), taxpayers with provisional income in excess of a second-tier threshold (\$34,000 in the case of unmarried taxpayers or \$44,000 in the case of married taxpayers filing joint returns) are required to include in gross income up to 85 percent of their Social Security or Railroad Retirement Tier 1 benefit.

If the taxpayer's provisional income exceeds the lower threshold but does not exceed the second-tier threshold, then the amount of the inclusion is the lesser of (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the lower threshold.

If the amount of provisional income exceeds the second-tier threshold, then the amount of the inclusion is the lesser of:

- (1) 85 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit or
- (2) the sum of:
  - (a) 85 percent of the excess of the taxpayer's provisional income over the second-tier threshold,plus,
  - (b) the smaller of (i) the amount of benefits that would have been included if the 50-percent inclusion rule (the rule in the previous paragraph) were applied, or (ii) one-half of the difference between the taxpayer's second-tier threshold and lower threshold.

### **Treatment of nonresident alien individuals**

If a nonresident alien individual is engaged in a trade or business within the United States during the taxable year, the individual is subject to U.S. tax at the normal graduated rates on net taxable income that is effectively connected with the conduct of the U.S. trade or business. U.S. source fixed or determinable annual or periodic income of a nonresident alien individual (for example, salary, wages, annuities, compensation, remuneration, and emoluments) that is not effectively connected with the conduct of a U.S. trade or business generally is subject to tax at a rate of 30 percent of the gross amount paid. This latter tax generally is collected by means of withholding (hence this tax is often called a "withholding tax"). Withholding taxes are often reduced or eliminated in the case of payments to residents of countries with which the United States has an income tax treaty.

For purposes of taxing the income of nonresident alien individuals, the income thresholds for including Social Security and Railroad Retirement Tier 1 benefits do not apply. Instead, a fixed percentage of any such benefit is included in gross income. Until January 1, 1995, that percentage was 50 percent. Thus, prior to 1995, a nonresident alien individual typically was subject to U.S. withholding tax at an effective rate of 15 percent on the gross amount of U.S. Social Security benefits. This tax was reduced or eliminated under some treaties. Although the Omnibus Budget Reconciliation Act of 1993 increased the inclusion of benefits in some cases for taxpayers other than nonresident aliens (to up to 85 percent of the benefits), it did not amend the rule that a nonresident alien individual was required to include 50 percent (and only 50 percent) of these benefits in gross income.

The implementing legislation for the General Agreement on Tariffs and Trade (P.L. 103-465) increased from 50 percent to 85 percent the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual, effective for benefits paid after December 31, 1994, in taxable years ending after such date. Thus, a nonresident alien individual may be subject to U.S. withholding tax at an effective rate of 25.5 percent on the gross amount of U.S. Social Security or Railroad Retirement Tier 1 benefits.

### **Trust funds**

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the 1993 Act increase in the portion of benefits included in gross income are credited quarterly to the Medicare Hospital Insurance (HI) Trust Fund. The remainder of the proceeds from the income taxation of Social Security and Railroad Retirement Tier 1 benefits are credited quarterly to the Old-Age and Survivors Insurance Trust Fund, the Disability Insurance Trust Fund, or the Social Security Equivalent Benefit Account (of the Railroad Retirement system), as appropriate.

## Description of Provision

### In general

The provision would phase in a repeal of the higher rate of income inclusion for taxpayers with provisional incomes in excess of the second-tier threshold.

For taxable years beginning in calendar years 1996 through 1999, if the amount of provisional income exceeds the second-tier threshold, then the amount of the inclusion would be calculated as under present law, except that the following rates would be substituted for "85 percent":

<u>For taxable years beginning in calendar year--</u>	<u>The percentage would be--</u>
1996 .....	75 percent
1997 .....	65 percent
1998 .....	60 percent
1999 .....	55 percent.

For taxable years beginning after December 31, 1999, Social Security and Railroad Retirement Tier 1 benefits would be treated as under the law prior to 1994: if the amount of provisional income exceeds \$25,000 in the case of unmarried taxpayers or \$32,000 in the case of married taxpayers filing joint returns, then the amount of the inclusion would be the lesser of (1) 50 percent of the taxpayer's Social Security or Railroad Retirement Tier 1 benefit, or (2) 50 percent of the excess of the taxpayer's provisional income over the threshold.

### Treatment of nonresident alien individuals

The provision would phase in a reduction in the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual. The inclusion percentage for any taxable year beginning in calendar years 1996 through 1999 would be as given in the table above. For taxable years beginning after December 31, 1999, the amount of Social Security or Railroad Retirement Tier 1 benefits included in the gross income of a nonresident alien individual would be 50 percent.

**Trust funds**

Revenues from the income taxation of Social Security and Railroad Retirement Tier 1 benefits attributable to the increased portion of benefits included in gross income under the 1993 Act (as phased out under the provision) would be credited to the Old-Age and Survivors Insurance Trust Fund.

**Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## **B. Treatment of Long-Term Care Insurance and Services**

### **Present Law**

#### **In general**

Present law generally does not provide explicit rules relating to the tax treatment of long-term care insurance contracts or long-term care services. Thus, the treatment of long-term care contracts and services is unclear. Present law does provide rules relating to medical expenses and accident or health insurance.

#### **Deduction for medical expenses**

In determining taxable income for Federal income tax purposes, a taxpayer is allowed an itemized deduction for unreimbursed expenses that are paid by the taxpayer during the taxable year for medical care of the taxpayer, the taxpayer's spouse, or a dependent of the taxpayer, to the extent that such expenses exceed 7.5 percent of the adjusted gross income of the taxpayer for such year (sec. 213).

#### **Exclusion for amounts received under accident or health insurance**

Amounts received by a taxpayer under accident or health insurance for personal injuries or sickness generally are excluded from gross income to the extent that the amounts received are not attributable to medical expenses that were allowed as a deduction for a prior taxable year (sec. 104).

#### **Treatment of accident or health plans maintained by employers**

Contributions of an employer to an accident or health plan that provides compensation (through insurance or otherwise) to an employee for personal injuries or sickness of the employee, the employee's spouse, or a dependent of the employee, are excluded from the gross income of the employee (sec. 106). In addition, amounts received by an employee under such a plan generally are excluded from gross income to the extent that the amounts received are paid, directly or indirectly, to reimburse the employee for expenses incurred by the employer for the medical care of the employee, the employee's spouse, or a dependent of the employee (sec. 105). For this purpose, expenses incurred for medical care are defined in the same manner as under the rules regarding the deduction for medical expenses.

A cafeteria plan is an employer-sponsored arrangement under which employees can elect among cash and certain employer-provided qualified benefits. No amount is included in the gross income of a participant in a cafeteria plan merely because the participant has the opportunity to make such an election (sec. 125). Employer-provided accident or health coverage is one of the benefits that may be offered under a cafeteria plan.

A flexible spending arrangement (FSA) is an arrangement under which an employee is reimbursed for medical expenses or other nontaxable employer-provided benefits, such as dependent care. An FSA may be part of a cafeteria plan or provided by an employer outside a cafeteria plan. FSAs are commonly used to reimburse employees for medical expenses not covered by insurance. If certain requirements are satisfied, amounts reimbursed for nontaxable benefits from an FSA are excludable from income.

### **Health care continuation rules**

The health care continuation rules require that an employer must provide qualified beneficiaries the opportunity to continue to participate for a specified period in the employer's health plan after the occurrence of certain events (such as termination of employment) that would have terminated such participation. Individuals electing continuation coverage can be required to pay for such coverage.

### **Life insurance company reserve rules**

In general, life insurance companies are allowed a deduction for a net increase in reserves and must take into income any net decreases in reserves. Present law prescribes a tax reserve method based on the nature of the contract. For noncancellable accident and health insurance contracts, the prescribed method is a two-year full preliminary term method. Long-term care insurance reserves are treated like noncancellable accident and health insurance for this purpose and, therefore, are subject to the two-year full preliminary term method of reserves. In no event is the tax reserve for any contract as of any time permitted to exceed the amount which would be taken into account in determining statutory reserves (i.e., set forth on the annual statement for State law reporting purposes). Under the National Association of Insurance Commissioners (NAIC) Long-Term Care Insurance Model Act and Regulations, which have been adopted by some States, by contrast, long-term care insurance reserves are calculated under a one-year full preliminary term method. Thus, because of this inconsistency, in some cases life insurance companies establish reserves for long-term care insurance contracts earlier for State regulatory purposes than they do for Federal tax purposes. In addition, some life insurance companies have voluntarily complied with the NAIC model act and regulations, even though not required to do so in all cases.

Changes in reserve amounts due to changes in the basis on which reserves are calculated are generally spread over a 10-year period.

## Description of Provisions

### Tax treatment and definition of long-term care insurance contracts and qualified long-term care services

#### In general

A long-term care insurance contract would be accorded the following tax treatment. A long-term care insurance contract would be treated as an accident and health insurance contract.<sup>3</sup> Amounts (other than policyholder dividends or premium refunds) received under a long-term care insurance contract would be excludable as amounts received for personal injuries and sickness. A plan of an employer providing coverage under a long-term care insurance contract generally would be treated as an accident and health plan; however, coverage under a long-term care insurance contract would not be excludable by an employee if provided through a cafeteria plan and expenses for long-term care services could not be reimbursed under an FSA.

Within certain limits, premiums for long-term care insurance would be treated as medical expenses for purposes of the itemized deduction for medical expenses. Similarly, expenses for qualified long-term care services would be treated as medical expenses for purposes of the itemized deduction.

#### Definition of long-term care insurance contract

A long-term care insurance contract would be defined as any insurance contract that provides only coverage of qualified long-term care services and that meets other requirements. The other requirements would be that (1) the contract is guaranteed renewable, (2) the contract does not provide for a cash surrender value or other money that can be paid, assigned, pledged or borrowed, (3) refunds (other than refunds on death of the insured or complete surrender or cancellation of the contract) and dividends under the contract may be used only to reduce future premiums or increase future benefits, and (4) the contract generally does not pay or reimburse expenses reimbursable under Medicare (except where Medicare is a secondary payor, or the contract makes per diem or other periodic payments without regard to expenses). A contract would not fail to be treated as a long-term care insurance contract solely because it provides for payments on a per diem or other periodic basis without regard to expenses during the period. Long-term care insurance contracts would not be subject to the rules requiring duplication of Medicare benefits.

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<sup>3</sup> Prior to December 31, 1993, a self-employed individual was entitled to deduct up to 25 percent of the health insurance expenses for the individual and his or her spouse and dependents. The provision would treat long-term care insurance as health insurance. Thus, if the 25-percent deduction were extended, it would apply to long-term care insurance premiums under the provision.

### Definition of qualified long-term care services

Qualified long-term care services would mean necessary diagnostic, preventive, therapeutic, curing, treating, mitigating and rehabilitative services, and maintenance or personal care services that are required by a chronically ill individual and that are provided pursuant to a plan of care prescribed by a licensed health care practitioner.

A chronically ill individual would be one who has been certified within the previous 12 months by a licensed health care practitioner as being unable to perform (without substantial assistance) at least 2 activities of daily living for at least 90 days due to a loss of functional capacity or cognitive impairment, or having a similar level of disability as determined by the Secretary of the Treasury in consultation with the Secretary of Health and Human Services. Activities of daily living would be eating, toileting, transferring, bathing, dressing and continence.

A licensed health care practitioner would be defined as a physician (as defined in sec. 1861(r)(1) of the Social Security Act) and any registered professional nurse, licensed social worker, or other individual who meets such requirements as may be prescribed by the Secretary of the Treasury.

### Deduction for medical expenses

Unreimbursed expenses for qualified long-term care services provided to the taxpayer or the taxpayer's spouse or dependent would be treated as medical expenses for purposes of the itemized deduction for medical expenses (subject to the present-law floor of 7.5 percent of adjusted gross income). Amounts received under a long-term care insurance contract (regardless of whether the contract reimburses expenses or pays benefits on a per diem or other basis) would be treated as reimbursement for expenses for this purpose. For purposes of this deduction, qualified long-term care services would not include services provided to an individual by a relative or a related corporation.

Within certain limits, long-term care insurance premiums would be treated as medical expenses for purposes of the itemized deduction for medical expenses. The limits are as follows:

**In the case of an individual  
with an attained age before  
the close of the taxable year of:**

**The limitation  
would be:**

Not more than 40.....	\$ 200
More than 40 but not more than 50	375
More than 50 but not more than 60	750
More than 60 but not more than 70	2,000
More than 70.....	2,500

Beginning after 1996, these dollar limits would be indexed for increases in the medical care component of the consumer price index. The Treasury Secretary would be directed to develop an index based on increases in skilled nursing facility and home health care costs, that would be substituted for the medical care component of the consumer price index.

**Long-term care riders on life insurance contracts**

In the case of long-term care insurance coverage provided by a rider on a life insurance contract, the requirements applicable to long-term care insurance contracts would apply as if the portion of the contract providing such coverage were a separate contract. The term "portion" would mean only the terms and benefits that are in addition to the terms and benefits under the life insurance contract without regard to long-term care coverage. The guideline premium limitation and adjustment rules applicable under present law to the life insurance contract would be modified appropriately to take account of charges with respect to the long-term care rider.

**Life insurance company reserves**

In determining reserves for insurance company tax purposes, the Federal income tax reserve method would be the method prescribed by the National Association of Insurance Commissioners, but no earlier and not in excess of the reserve under the method actually used by the company with respect to the long-term care insurance contract for determining statutory reserves.

**Health care continuation rules**

The health care continuation rules would not apply to coverage under a long-term care insurance contract.

**Exchanges of life insurance and other contracts for long-term care insurance contracts**

The exchange of a life insurance contract or an endowment or annuity contract for a qualified long-term care insurance contract would not be taxable.

## **Certain distributions from IRAs and retirement plans for long-term care insurance excludable from income**

The provision would exclude from gross income distributions from individual retirement arrangements (IRAs) and distributions attributable to elective deferrals to qualified cash or deferred arrangements (sec. 401(k) plans), tax-sheltered annuities (sec. 403(b) plans), nonqualified deferred compensation plans of governmental or tax-exempt employers (sec. 457 plans), and section 501(c)(18) plans used to pay premiums for long-term care insurance for the individual or the individual's spouse. Such distributions would also not be subject to the 10-percent tax on early withdrawals. Such plans would not fail to meet the qualification requirements applicable to such plans merely because they permit such distributions.

### **Inclusion of excess long-term care benefits**

In general, the provision would provide that the maximum annual amount of long-term care benefits excludable from income with respect to an insured who is chronically ill (but not terminally ill)<sup>4</sup> as of the date the benefit is received could not exceed the equivalent of \$200 per day for each day the individual is chronically ill. Thus, the maximum annual exclusion for long-term care benefits with respect to any chronically ill individual (who is not terminally ill) would be \$73,000 (for 1996). Long-term care benefits would include benefits paid under a long-term care insurance contract with respect to the insured and benefits excludable from income under the provision relating to accelerated death benefits by reason of the insured being chronically ill (but not terminally ill). If the insured is not the same as the holder of the contract, the insured may assign some or all of this limit to the contract holder at the time and manner prescribed by the Secretary.

This \$200 per day limit would be indexed for inflation after 1996 for increases in the medical care component of the consumer price index. The Secretary of the Treasury would be directed to develop an index based on increases in skilled nursing facility and home health care costs that would be substituted for the medical care component of the consumer price index.

A payor of long-term care benefits (as defined above) would be required to report the amount of such benefits.

### **Effective Date**

The provisions defining long-term care insurance contracts and qualified long-term care services would apply to contracts issued after December 31, 1995. Any contract issued before January 1, 1996, that met the long-term care insurance requirements in the State in which the policy

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<sup>4</sup> Terminally ill would be defined as under the provisions relating to accelerated death benefits. In general, under that provision, a person would be considered to be terminally ill if they were certified as having an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of the certification.

was situated at the time it was issued would be treated as a long-term care insurance contract, and services provided under or reimbursed by the contract would be treated as qualified long-term care services.

A contract providing for long-term care insurance could be exchanged for a long-term care insurance contract (or the former cancelled and the proceeds reinvested in the latter within 60 days) tax-free between the date of enactment and January 1, 1996. Taxable gain would be recognized to the extent money or other property is received in the exchange.

The issuance or conformance of a rider to a life insurance contract providing long-term care insurance coverage would not be treated as a modification or a material change for purposes of applying sections 101(f), 7702 and 7702A of the Code.

The provisions relating to (1) treatment as a medical expense of qualified long-term care insurance services and eligible long-term care premiums and (2) tax-free exchanges of life insurance, endowment and annuity contracts for long-term care insurance contracts, are effective for taxable years beginning after December 31, 1995.

The change in treatment of reserves for long-term care insurance contracts would be effective for contracts issued after December 31, 1995. In the event a company changes its reserve method as set forth on the annual statement for long-term care insurance contracts after that date, the amount of any adjustment arising from the change in tax reserve amounts would be spread over a 10-year period.

The provision relating to certain distributions from IRAs and elective deferrals used to pay long-term care insurance premiums is effective for payments and distributions after December 31, 1995.

The provision relating to the maximum exclusion for long-term care benefits would be effective for taxable years beginning after December 31, 1995.

## **C. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts**

### **Present Law**

#### **Treatment of amounts received under a life insurance contract**

If a contract meets the definition of a life insurance contract, gross income does not include insurance proceeds that are paid pursuant to the contract by reason of the death of the insured (sec. 101(a)). In addition, the undistributed investment income ("inside buildup") earned on premiums credited under the contract is not subject to current taxation to the owner of the contract. The exclusion under section 101 applies regardless of whether the death benefits are paid as a lump sum or otherwise.

Amounts received under a life insurance contract (other than a modified endowment contract) prior to the death of the insured are includible in the gross income of the recipient to the extent that the amount received exceeds the taxpayer's investment in the contract (generally, the aggregate amount of premiums paid less amounts previously received that were excluded from gross income).

If a contract fails to be treated as a life insurance contract under section 7702(a), inside buildup on the contract is generally subject to tax.

#### **Requirements for a life insurance contract**

To qualify as a life insurance contract for Federal income tax purposes, a contract must be a life insurance contract under the applicable State or foreign law and must satisfy either of two alternative tests: (1) a cash value accumulation test or (2) a test consisting of a guideline premium requirement and a cash value corridor requirement (sec. 7702(a)). A contract satisfies the cash value accumulation test if the cash surrender value of the contract may not at any time exceed the net single premium that would have to be paid at such time to fund future benefits under the contract. A contract satisfies the guideline premium and cash value corridor tests if the premiums paid under the contract do not at any time exceed the greater of the guideline single premium or the sum of the guideline level premiums, and if the death benefit under the contract is not less than a varying statutory percentage of the cash surrender value of the contract.

#### **Proposed regulations on accelerated death benefits**

The Treasury Department has issued proposed regulations under which certain "qualified accelerated death benefits" paid by reason of the terminal illness of an insured are treated as paid by reason of the death of the insured and therefore qualify for exclusion under section 101. In addition, the proposed regulations permit an insurance contract that includes a qualified accelerated death benefit rider to qualify as a life insurance contract under section 7702. Thus, the proposed regulations provide that including this benefit would not cause an insurance contract to fail to meet the definition of a life insurance contract.

Under the proposed regulations, a benefit qualifies as a qualified accelerated death benefit only if it meets three requirements. First, the accelerated death benefit can be payable only if the insured becomes terminally ill (as described below). Second, the amount of the benefit must equal or exceed the present value of the reduction in the death benefit otherwise payable.<sup>5</sup> Third, the cash surrender value and the death benefit payable under the policy must be reduced proportionately as a result of the accelerated death benefit.

For purposes of the proposed regulations, an insured is treated as terminally ill if he or she has an illness that, despite appropriate medical care, the insurer reasonably expects to result in death within twelve months from the payment of the accelerated death benefit. The proposed regulations do not apply to viatical settlements.

### **Description of Provision**

The provision would provide an exclusion from gross income for (1) any amount received under a life insurance contract and (2) any amount received for the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured under the life insurance contract is either terminally ill or chronically ill.

The provision would not apply in the case of an amount paid to any taxpayer other than the insured, if such taxpayer has an insurable interest by reason of the insured being a director, officer or employee of the taxpayer, or by reason of the insured being financially interested in any trade or business carried on by the taxpayer.

Under the provision, an individual would be considered terminally ill if a physician<sup>6</sup> has certified that the individual has an illness or physical condition that reasonably can be expected to result in death within 24 months of the date of certification.

A "chronically ill" individual would be defined as under the separate provision relating to long-term care. With respect to a chronically ill individual (who is not also terminally ill), the \$200 per day limitation on excess benefits under the separate long term care provision also would apply to accelerated death benefit payments in a manner reflecting the period that the individual is chronically ill.

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<sup>5</sup> For purposes of determining the present value, the maximum permissible discount rate is the greater of (1) the applicable Federal rate that applies under the discounting rules for property and casualty insurance loss reserves, and (2) the interest rate applicable to policy loans under the contract. Also, the present value is determined assuming that the death benefit would have been paid twelve months after payment of the accelerated death benefit.

<sup>6</sup> The term "physician" would have the same meaning as in sec. 1861(r)(1) of the Social Security Act.

A qualified viatical settlement provider would be any person that regularly purchases or takes assignments of life insurance contracts on the lives of terminally ill or chronically ill individuals and either (1) is licensed for such purposes in the State in which the insured resides, or (2) if the person is not required to be licensed by that State, meets the requirements of sections 8 and 9 of the Viatical Settlements Model Act, issued by the National Association of Insurance Commissioners.

For life insurance company tax purposes, the provision would treat a qualified accelerated death benefit rider to a life insurance contract as life insurance. A qualified accelerated death benefit rider would be any rider on a life insurance contract that provides only for payments of a type that are excludable under this provision.

The issuance of a qualified accelerated death benefit rider to a life insurance contract would not be treated as a modification or material change of the contract (and is not intended to affect the issue date of any contract under section 101(f)).

#### **Effective Date**

The provision would apply to amounts received after December 31, 1995. The provision treating a qualified accelerated death benefit rider as life insurance for life insurance company tax purposes would be effective on January 1, 1996.

### **III. JOB CREATION AND WAGE ENHANCEMENT TAX ACT (TITLE III)**

#### **A. Capital Gains Provisions**

##### **1. 50-percent capital gains deduction for individuals**

###### **Present Law**

In general, gain or loss reflected in the value of an asset is not recognized for income tax purposes until a taxpayer disposes of the asset. On the sale or exchange of capital assets, the net capital gain is taxed at the same rate as ordinary income, except that individuals are subject to a maximum marginal rate of 28 percent of the net capital gain. Net capital gain is the excess of the net long-term capital gain for the taxable year over the net short-term capital loss for the year. Gain or loss is treated as long-term if the asset is held more than one year.

The Revenue Reconciliation Act of 1993 provided a 50-percent exclusion for gain from the sale of certain small business stock acquired at original issue and held for at least five years. One-half of the excluded amount is a minimum tax preference.

Prior to the enactment of the Tax Reform Act of 1986, individuals were allowed a deduction equal to 60 percent of net capital gain. The deduction resulted in a maximum effective tax rate of 20 percent on such gains.

Capital losses are generally deductible in full against capital gains. In addition, individuals may deduct capital losses against up to \$3,000 of ordinary income in each year. Capital losses in excess of the amount deductible are carried forward indefinitely in the case of individuals, and generally carried back three years and forward five years in the case of corporations. Prior to the Tax Reform Act of 1986, individuals were required to use two dollars of long-term capital loss to offset each dollar of ordinary income.

###### **Description of Provision**

The provision would allow individuals a deduction equal to 50 percent of net capital gain for the taxable year. The provision would repeal the present-law maximum 28-percent rate. Thus, the effective rate on the net capital gain of an individual in the highest (i.e., 39.6 percent) rate bracket would be 19.8 percent.

The provision would repeal the provisions in the Revenue Reconciliation Act of 1993 providing a capital gain exclusion for sales of certain small business stock.

The provision would reinstate the rule in effect prior to the 1986 Tax Reform Act that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The \$3,000 limitation on the deduction of capital losses against ordinary income would continue to apply.

Collectibles would be excluded from net capital gain. However, an individual could elect to apply a maximum rate of 28 percent to the net capital gain attributable to collectibles, if the individual foregoes the benefit of indexing the basis of the collectible.

#### **Effective Date**

The provision generally would apply to taxable years ending after December 31, 1994.

For a taxpayer's 1994-95 fiscal year or for the 1995 calendar year of a taxpayer holding interests in one or more 1994-95 fiscal year pass-thru entities, the 50-percent capital gains deduction would apply to the lesser of (1) the net capital gain for the taxable year, or (2) the net capital gain determined by taking into account gain or loss properly taken into account for the portion of the taxable year on or after January 1, 1995. Any net capital gain not eligible for the 50-percent capital gains deduction would be subject to the present-law maximum rate of 28 percent. This generally has the effect of applying the 50-percent deduction to capital assets sold or exchanged (or installment payments received) on or after January 1, 1995, and subjecting gains from capital assets sold before that date to a maximum rate of 28 percent.

In the case of gain taken into account by a pass-through entity (i.e., a RIC, a REIT, an S corporation, a partnership, an estate or trust, or a common trust fund), the date taken into account by the entity is the appropriate date for applying the rule in the preceding paragraph. Thus, gain taken into account by a fiscal-year pass-thru entity in 1994 which an owner takes into account on its calendar-year 1995 income tax return would not be eligible for the new capital gains deduction.

A taxpayer holding small business stock on the date of enactment would be able to elect, within one year from the date of enactment, to have the provision of present law (rather than this provision) apply to any gain from the sale of the stock.

The capital loss rule would not apply to losses arising in taxable years beginning before January 1, 1996.

## **2. Indexing of basis of certain assets for purposes of determining gain**

### **Present Law**

Under present law, the amount taken into account in computing gain or loss from the disposition of any asset is the sales price of the asset reduced by the taxpayer's basis in that asset. The taxpayer's basis generally is the taxpayer's cost in the asset adjusted for depreciation, depletion, and certain other amounts. No adjustment is allowed for inflation.

### **Description of Provision**

#### **In general**

The provision generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain (but not loss) upon a sale or other disposition of such assets.

The provision would apply to assets acquired after December 31, 1994, held by taxpayers other than C corporations. Assets held by individuals, trusts, estates, S corporations, regulated investment companies ("RICs"), real estate investment trusts ("REITs"), and partnerships would be eligible for indexing, to the extent gain is taken into account by taxpayers other than C corporations.

#### **Indexed assets**

Assets the basis of which would be eligible for the inflation adjustment generally would include common stock of C corporations and tangible property that are capital assets or property used in a trade or business and are held by the taxpayer for more than three years. No property using neutral cost recovery would be an indexed asset.

#### **Computation of inflation adjustment**

The inflation adjustment under the provision would be computed by multiplying the taxpayer's adjusted basis in the indexed asset by the percentage by which the GDP deflator for the last calendar quarter ending before the disposition exceeds the GDP deflator for the last calendar quarter ending before the asset was acquired by the taxpayer. The inflation adjustment would be rounded to the nearest one-tenth of a percent. No adjustment would be made if the inflation adjustment is one or less.

#### **Special entities**

##### **RICs and REITs**

In the case of shares held in a RIC or REIT, partial indexing would be provided based on the

ratio of the value of indexed assets held by the entity to its total assets. This ratio would be determined every quarter (based on a three-month average). If the ratio of indexed assets to total assets exceeds 80 percent in any quarter, full indexing of the shares would be allowed for that quarter. If less than 20 percent of the assets are indexed assets in any quarter, no indexing would be allowed for that quarter for the shares. Partnership interests held by a RIC or REIT would be subject to a look-through test for purposes of determining whether, and to what degree, the shares in the RIC or REIT could be indexed.

A return of capital distribution by a RIC or REIT would be treated by a shareholder as allocable to stock acquired by the shareholder in the order in which the stock was acquired.

#### Partnership and S corporations, etc.

Under the provision, stock in an S corporation or an interest in a partnership or common trust fund would not be an indexed asset. Instead, the individual owner would receive the benefit of the indexing adjustment when the corporation, partnership, or common trust fund disposes of indexed assets. Under the provision, any inflation adjustments at the entity level would flow through to the holders and result in a corresponding increase in the basis of the holder's interest in the entity. If a partnership has a section 754 election in effect, a partner transferring his interest in the partnership would be entitled to any indexing adjustment that has accrued at the partnership level with respect to the partner and the transferee partner would be entitled to the benefits of indexing for inflation occurring after the transfer.

The indexing adjustment would be disregarded in determining any loss on the sale of an interest in a partnership, S corporation or common trust fund.

#### Foreign corporations

Common stock of a foreign corporation generally would be an indexed asset only if the stock is regularly traded on an established securities market. Indexed assets, however, would not include stock in certain foreign corporations that are controlled by U.S. investors, or that hold substantial amounts of passive assets, or earn substantial amounts of passive income. An American Depositary Receipt (ADR) for common stock in a foreign corporation would be treated as common stock in the foreign corporation and, therefore, the basis in an ADR for common stock generally would be indexed.

#### Other rules

##### Improvements and contributions to capital

No indexing would be provided for improvements or contributions to capital if the aggregate amount during the taxable year with respect to the property or stock is less than \$1,000. If the aggregate amount of such improvements or contributions to capital is \$1,000 or more, each addition

would be treated as a separate asset acquired at the close of the taxable year.

#### Suspension of holding period

No indexing adjustments would be allowed during any period during which there is a substantial diminution of the taxpayer's risk of loss from holding the indexed asset by reason of any transaction that the taxpayer, or a related party, entered into.

#### Short sales

In the case of a short sale of an indexed asset with a short sale period in excess of three years, the provision would provide that the amount realized would be indexed for inflation in the same manner that the basis would be indexed to the holder of the property.

#### Related parties

The provision would not index the basis of property for sales or dispositions between related persons, except to the extent the basis of property in the hands of the transferee is a substitute basis (e.g., gifts).

#### Collapsible corporations

Under the provision, indexing would not reduce the amount of ordinary gain that would be recognized in cases where a corporation is treated as a collapsible corporation (under sec. 341) with respect to a distribution or sale of stock.

#### Effective Date

The provisions would apply to property acquired after December 31, 1994. A taxpayer holding any indexed asset on January 1, 1995, may elect to treat the indexed asset as having been sold on such date for an amount equal to its fair market value, and as having been reacquired for an amount equal to such value. If the election is made, the asset would be eligible for indexing under the provision. Any gain resulting from the election is treated as received on the date of the deemed sale, and any loss is not allowed. The adjusted basis of a principal residence that is held and used by an individual on January 1, 1995 is subject to the indexing provision as of such date.

### **3. 25-percent corporate alternative tax for capital gains**

#### **Present Law**

Under present law, the net capital gain of a corporation is taxed at the same rate as ordinary income, and subject to tax at graduated rates up to 35 percent. Prior to the Tax Reform Act of 1986, the net capital gain of a corporation was subject to a maximum effective tax rate of 28 percent (and the highest rate was 46 percent for ordinary income).

#### **Description of Provision**

The provision would provide an alternative tax of 25 percent on the net capital gain of a corporation if that rate is less than the corporation's regular tax rate.

#### **Effective Date**

The provision generally would apply to taxable years ending after December 31, 1994. For taxable years ending after December 31, 1994, and beginning before January 1, 1996, the 25- percent rate would apply to the lesser of (1) the net capital gain for the taxable year or (2) the net capital gain taking into account only gain or loss properly taken into account for the portion of the taxable year after December 31, 1994. The pass-through entity rules that apply to the capital gain deduction for individuals would also apply for corporations.

#### **4. Capital loss deduction allowed with respect to the sale or exchange of a principal residence**

##### **Present Law**

Taxpayers generally may claim as a deduction any loss sustained during the taxable year and not compensated by insurance or otherwise. In the case of an individual, however, the deduction is limited to (1) losses incurred in a trade or business, (2) losses incurred in any transaction entered into for profit though not connected with a trade or business, and (3) catastrophic losses of property that arise from fire, storm, shipwreck, or other casualty or from theft. Deductions for losses from the sale or exchange of capital assets are subject to the limitations described above. In addition, taxpayers other than corporations may deduct capital losses against up to \$3,000 of ordinary income each year.

A loss on the sale or exchange of a principal residence is treated as a nondeductible personal loss. Gain on the sale or exchange of a principal residence generally is includible in gross income and is subject to a maximum rate of 28 percent. If an individual purchases a new principal residence within two years of selling the old residence, gain from the sale of the old residence (if any) is recognized only to the extent that the taxpayer's adjusted sales price exceeds the taxpayer's cost of purchasing the new residence (sec. 1034). A taxpayer also may elect to exclude from gross income up to \$125,000 of gain from the sale of a principal residence if the taxpayer (1) has attained age 55 before the sale and (2) has used the residence as a principal residence for three or more years of the five years preceding the sale of the residence (sec. 121). This election may be made only once.

##### **Description of Provision**

The provision would provide that losses from the sale or exchange of a principal residence would be treated as a deductible capital loss rather than a nondeductible personal loss.

##### **Effective Date**

The provision would be effective for sales and exchanges after December 31, 1994, in taxable years ending after such date.

## **B. Cost Recovery Provisions**

### **1. Neutral cost recovery**

#### **Present Law**

Under present law, a taxpayer is allowed depreciation deductions for the cost of property used in a trade or business. In general, depreciation for tangible property placed in service after 1986 is determined under the modified Accelerated Cost Recovery System ("MACRS") enacted as part of the Tax Reform Act of 1986. MACRS includes a general depreciation system and an alternative depreciation system.

Under the general MACRS rules, property is divided into nine classes based on recovery periods (3-year property, 5-year property, 7-year property, 10-year property, 15-year property, 20-year property, 27.5-year residential rental property, 39-year nonresidential real property and 50-year railroad grading or tunnel bores) and is depreciated over such periods. The 200-percent declining balance method of depreciation is used for 3-year, 5-year, 7-year, and 10-year property; the 150-percent declining balance method is used for 15-year and 20-year property and property used in a farming business; and the straight-line method is used for other property (including real property).

In general, the value of MACRS deductions are reduced under the alternative depreciation system by calculating depreciation using the straight-line method over the property's class life.<sup>7</sup> A property's class life generally corresponds to its Asset Depreciation Range ("ADR") midpoint life and often is longer than the recovery period available under the general MACRS. (The class lives and recovery periods of some assets are set by statute, regardless of the asset's ADR midpoint life.) The alternative depreciation system applies to foreign use property, tax-exempt use property, tax-exempt bond financed property, certain imported property, and property to which the taxpayer so elects and is used to compute corporate earnings and profits. The class lives of the alternative depreciation system are used for purposes of the corporate and individual alternative minimum tax. The alternative minimum tax generally applies the 150-percent declining balance method to tangible personal property placed in service after 1993.

#### **Description of Provision**

For MACRS property placed in service after December 31, 1994, the provision would allow a taxpayer to elect, on a property-by-property basis, to determine depreciation deductions under present law or under a new neutral cost recovery system ("NCRS"). The following describes the treatment of property under NCRS.

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<sup>7</sup> Annual depreciation deductions for passenger automobiles also are limited under section 280F.

First, NCRS generally would follow MACRS but would replace the 200-percent declining balance method of MACRS applicable to shorter-lived property with the 150-percent declining balance method.

In addition, depreciation for any taxable year after the year in which the property is placed in service would be determined by multiplying the deduction allowable for the property for the taxable year (determined without regard to this provision) by the "applicable neutral cost recovery ratio" for the year.

In the case of property that would otherwise qualify for the 200-percent declining balance method (but for the election to use NCRS), the applicable neutral cost recovery ratio for the taxable year is first determined by dividing (1) the gross domestic product deflator for the taxable year by (2) the gross domestic product deflator for the year the property was placed in service by the taxpayer. This ratio is then multiplied by the number equal to 1.035 raised to the nth power, where "n" is the number of full years since the property was placed in service by the taxpayer. In the case of other MACRS property (e.g., longer-lived property and property to which the alternative depreciation system applies), the applicable neutral cost recovery ratio for the taxable year is determined by dividing (1) the gross domestic product deflator for the taxable year by (2) the gross domestic product deflator for the year the property was placed in service by the taxpayer.

The gross domestic product deflator for any taxable year is the price deflator released by the Department of Commerce for the gross domestic product for the calendar quarter that includes the mid-point of the taxpayer's taxable year. Thus, for example, the gross domestic product deflator for a taxpayer with a fiscal year ending November 30 is the deflator published for the calendar quarter ending June 30.<sup>8</sup> The appropriate deflator for any calendar quarter would be the last deflator for such quarter released by the Department of Commerce before the end of the next calendar quarter.

For any property, the applicable neutral cost recovery ratio may not be less than one and is rounded to the nearest one-thousandth.

The depreciation allowances provided under NCRS for regular tax purposes also would be applied for alternative minimum tax purposes (including for purposes of the adjusted current earnings component of the corporate alternative minimum tax).

The application of the applicable neutral cost recovery ratio generally would not be taken into account for purposes of (1) determining the adjusted basis of depreciable property,<sup>9</sup> any interest in

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<sup>8</sup> The Secretary of the Treasury would be authorized to provide such rules as are necessary to determine the appropriate deflator for any taxable year that is a short year.

<sup>9</sup> The additional deductions allowed by the provision would increase the "unrecovered basis" of a passenger automobile to the extent such deductions are not allowed by reason of section 280F.

a pass-through entity (as defined in proposed sec. 1201(d)(2)), or the stock of a consolidated subsidiary; (2) determining earnings and profits; or (3) the recapture provisions of sections 1245 and 1250. The additional deductions determined under NCRS would be subject to the built-in loss rules of section 382. Finally, the additional deductions determined under NCRS would not be subject to the at-risk rules to the extent the taxpayer's underlying MACRS depreciation deductions are not subject to the at-risk rules.

NCRS would not apply to any property for which the taxpayer so elects<sup>10</sup> or to property placed in service pursuant to certain churning transactions.

#### **Effective Date**

The provision would be effective for qualifying property placed in service after December 31, 1994.

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<sup>10</sup> Any election, once made, would be irrevocable.

## 2. Treatment of leasehold improvements

### Present Law

#### Depreciation of leasehold improvements

Improvements made on leased property are depreciated under the modified Accelerated Cost Recovery System ("MACRS"), even if the MACRS recovery period assigned to the property is longer than the term of the lease (sec. 168(i)(8)).<sup>11</sup> This rule applies regardless whether the lessor or lessee places the leasehold improvements in service.<sup>12</sup> If a leasehold improvement constitutes an addition or improvement to nonresidential real property already placed in service, the improvement is depreciated using the straight-line method over a 39-year recovery period, beginning in the month the addition or improvement was placed in service (secs. 168(b)(3), (c)(1), (d)(2), and (i)(6)).<sup>13</sup>

#### Treatment of dispositions of leasehold improvements

A taxpayer generally recovers the adjusted basis of property for purposes of determining gain or loss upon the disposition of the property. Upon the termination of a lease, the adjusted basis of leasehold improvements that were made, but are not retained, by a lessee are taken into account to compute gain or loss by the lessee.<sup>14</sup> The proper treatment of the adjusted basis of improvements

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<sup>11</sup> Prior to the adoption of the Accelerated Cost Recovery System ("ACRS") by the Economic Recovery Act of 1981, taxpayers were allowed to depreciate the various components of a building as separate assets with separate useful lives. The use of component depreciation was repealed upon the adoption of ACRS. The denial of component depreciation also applies under MACRS, as provided by the Tax Reform Act of 1986.

<sup>12</sup> Former Code sections 168(f)(6) and 178 provided that in certain circumstances, a lessee could recover the cost of leasehold improvements made over the remaining term of the lease. These provisions were repealed by the Tax Reform Act of 1986.

<sup>13</sup> If the improvement is characterized as tangible personal property, ACRS depreciation is calculated using the shorter recovery periods and accelerated methods applicable to such property. The determination of whether certain improvements are characterized as tangible personal property or as nonresidential real property often depends on whether or not the improvements constitute a "structural component" of a building (as defined by Treas. Reg. sec. 1.48-1(e)(1)). See, for example, Metro National Corp., 52 TCM 1440 (1987); King Radio Corp., 486 F.2d 1091 (10th Cir., 1973); Mallinckrodt, Inc., 778 F.2d 402 (8th Cir., 1985) (with respect various leasehold improvements).

<sup>14</sup> See, Report of the Committee on Ways and Means on H.R. 3838 (H. Rept. 99-426), p. 158, and Senate Finance Committee Report on H.R. 3838 (S. Rept. 99-313), p. 105 (Tax Reform Act of 1986, 99th Cong.).

made by a lessor upon termination of a lease is less clear. Proposed Treasury regulation section 1.168-2(e)(1) provides that the unadjusted basis of a building's structural components must be recovered as whole. In addition, proposed Treasury regulation sections 1.168-2(l)(1) and 1.168-6(b) provide that "disposition" does not include the retirement of a structural component of real property if there is no disposition of the underlying building.<sup>15</sup> Thus, it appears that it is the position of the Internal Revenue Service that leasehold improvements made by a lessor that constitute structural components of a building must be continued to be depreciated in the same manner as the underlying real property, even if such improvements are retired at the end of the lease term.<sup>16</sup> Some lessors, on the other hand, may be taking the position that a leasehold improvement is a property separate and distinct from the underlying building and that an abandonment loss under section 165 is allowable at the end of the lease term for the adjusted basis of the property. In addition, lessors may argue that even if a leasehold improvement constitutes a structural component of a building, proposed Treasury regulation section 1.168-2(l)(1) (that seemingly denies the deduction at the end of the lease term) applies only to retirements, but not abandonments or demolitions, of such property.<sup>17</sup> Thus, it appears that some lessors take the position that, at least in certain circumstances, the adjusted basis of leasehold improvements may be recovered at the end of the term of the lease to which the improvements relate even if there is no disposition of the underlying building.

#### **Description of Provision**

The provision would conform the treatment of lessors and lessees with respect to leasehold improvements disposed of at the end of a term of lease. Thus, under the provision, a lessor that disposes of a leasehold improvement at the end of the term of a lease would be allowed to recover the adjusted basis of the improvement at that time.

#### **Effective Date**

The provision would be effective for leasehold improvements disposed of after March 13, 1995. No inference is intended as to the proper treatment of such dispositions before March 14, 1995.

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<sup>15</sup> For example, if a taxpayer places a new roof on building subject to ACRS, the taxpayer must continue to depreciate the allocable cost of the old roof as part of the cost of the underlying building. (Prop. Treas. reg. sec. 1.168-6(b)(1)) See, also, Joint Committee on Taxation, General Explanation of the Economic Recovery Tax Act of 1981 (97th Cong.), p. 86.

<sup>16</sup> See, IRS General Information Letter, dated Sept. 17, 1992.

<sup>17</sup> Compare the second and fourth sentences of proposed Treasury regulation section 1.168-2(l)(1).

## **C. Alternative Minimum Tax**

### **Present Law**

#### **In general**

Present law imposes a minimum tax on an individual or a corporation to the extent the taxpayer's minimum tax liability exceeds its regular tax liability. The individual minimum tax is imposed at rates of 26 and 28 percent on alternative minimum taxable income in excess of a phased-out exemption amount; the corporate minimum tax is imposed at a rate of 20 percent on alternative minimum taxable income in excess of a phased-out \$40,000 exemption amount. Alternative minimum taxable income ("AMTI") is the taxpayer's taxable income increased by certain preference items and adjusted by determining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items. In the case of a corporation, in addition to the regular set of adjustments and preferences, there is a second set of adjustments known as the "adjusted current earnings" adjustment.

#### **Preference items in computing AMTI**

The minimum tax preference items are:

(1) The excess of the deduction for percentage depletion over the adjusted basis of the property at the end of the taxable year. For taxable years beginning after 1992, this preference does not apply to percentage depletion allowed with respect to oil and gas properties.

(2) The amount by which excess intangible drilling costs arising in the taxable year exceed 65 percent of the net income from oil, gas, and geothermal properties. For taxable years beginning after 1992, this preference does not apply to independent producers to the extent the producer's AMTI is reduced by 40 percent or less by ignoring the preference.

(3) The amount that a financial institution's bad debt deduction determined under section 593 exceeds the amount that would have determined based on the institution's actual experience.

(4) Tax-exempt interest income on private activity bonds (other than qualified 501(c)(3) bonds) issued after August 7, 1986.

(5) Accelerated depreciation or amortization on certain property placed in service before January 1, 1987.

(6) One-half of the amount excluded from income under section 1202 (relating to gains on the sale of certain small business stock).

In addition, losses from any tax shelter farm or passive activities are denied.<sup>18</sup>

### **Adjustments in computing AMTI**

The adjustments that all taxpayers must make are:

(1) Depreciation on property placed in service after 1986 must be computed by using the generally longer class lives prescribed by the alternative depreciation system of section 168(g) and either (a) the straight-line method in the case of property subject to the straight-line method under the regular tax or (b) the 150-percent declining balance method in the case of other property.

(2) Mining exploration and development costs must be capitalized and amortized over a 10-year period.

(3) Taxable income from a long-term contract (other than a home construction contract) must be computed using the percentage of completion method of accounting.

(4) The amortization deduction allowed for pollution control facilities (generally determined using 60-month amortization for a portion of the cost of the facility under the regular tax) must be calculated under the alternative depreciation system.

(5) Dealers in property (other than certain dealers of timeshares and residential lots) may not use the installment method of accounting.

The adjustments applicable to individuals are:

(1) Miscellaneous itemized deductions;

(2) State, local, and foreign real property taxes; State and local personal property taxes; and State, local, and foreign income, war profits, and excess profits taxes;

(3) Medical expenses except to the extent in excess of ten percent of the taxpayer's adjusted gross income;

(4) Standard deductions and personal exemptions;

(5) The amount allowable as a deduction for circulation expenditures must be capitalized and amortized over a 3-year period;

(6) The amount allowable as a deduction for research and experimental expenditures must be

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<sup>18</sup> Given the passage of section 469 (relating to the deductibility of losses from passive activities), these provisions are largely deadwood.

capitalized and amortized over a 10-year period<sup>19</sup>; and

- (7) The special rules relating to incentive stock options.

The adjustments applicable to corporations are:

- (1) The special rules applicable to Merchant Marine capital construction funds;
- (2) The special deduction allowable under section 833(b) (relating to Blue Cross and Blue Shield organizations); and
- (3) The adjusted current earnings adjustment.

### **Adjusted current earnings (ACE) adjustment**

The adjusted current earnings adjustment is the amount equal to 75 percent of the amount by which the adjusted current earnings (ACE) of a corporation exceeds its AMTI (determined without the ACE adjustment and the alternative tax net operating loss deduction).<sup>20</sup> In determining ACE, the following rules apply:

- (1) For property placed in service before 1994, depreciation generally is determined using the straight-line method and the class life determined under the alternative depreciation system.<sup>21</sup>
- (2) Any amount that is excluded from gross income under the regular tax but is included for purposes of determining earnings and profits is included in determining ACE.<sup>22</sup>
- (3) The inside build-up of a life insurance contract is includible in ACE (and the related premiums are deductible).
- (4) Intangible drilling costs (other than those incurred by an independent producer after 1992)

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<sup>19</sup> No adjustment is required if the taxpayer materially participates in the activity that relates to the research and experimental expenditures.

<sup>20</sup> If ACE is less than AMTI, the ACE adjustment may reduce AMTI to the extent of prior-year ACE inclusions.

<sup>21</sup> No ACE adjustment is required for property placed in service after 1993.

<sup>22</sup> Exceptions and special rules are provided for related expenses that are not deductible for regular tax purposes but reduce earnings and profits, the dividends received deduction relating to certain dividends, taxes on dividends from 936 companies, and certain dividends received by certain cooperatives.

must be capitalized and amortized over a 60-month period.

(5) The regular tax rules of sections 173 (relating to circulation expenditures) and 248 (relating to organizational expenditures) do not apply.

(6) Inventory must be calculated using the FIFO, rather LIFO, method.

(7) The installment sales method generally may not be used.

(8) No loss may be recognized on the exchange of any pool of debt obligations for another pool of debt obligations having substantially the same effective interest rates and maturities.

(9) Depletion (other than depletion claimed by an independent producer after 1992) must be calculated using the cost, rather than the percentage, method.

(10) In certain cases, the assets of a corporation that has undergone an ownership change must be stepped-down to their fair market values.

### **Other rules**

The combination of the taxpayer's net operating loss carryover and foreign tax credits cannot reduce the taxpayer's alternative minimum tax liability by more than 90 percent of the amount determined without these items.

The various credits allowed under the regular tax generally are not allowed against the alternative minimum tax.

If a taxpayer is subject to alternative minimum tax in one year, such amount of tax is allowed as a credit in a subsequent taxable year to the extent the taxpayer's regular tax liability exceeds its tentative minimum tax in such subsequent year. If the taxpayer is an individual, this credit is allowed to the extent the taxpayer's alternative minimum tax liability is a result of adjustments that are timing in nature.

### **Description of Provision**

#### **Repeal of the corporate alternative minimum tax**

The provision would repeal the corporate alternative minimum tax for taxable years beginning after December 31, 2000. The individual alternative minimum tax, as amended by the provision, would remain in existence. In addition, as described below, the provision would make certain changes to the corporate and individual alternative minimum taxes for taxable years beginning before January 1, 2001.

### **Preference items in computing AMTI**

The provision would make the following changes to the minimum tax preference items:

(1) The preference relating to depletion would be repealed for depletion claimed in taxable years beginning after December 31, 1995.

(2) The preference relating to intangible drilling costs would be repealed for costs incurred in taxable years beginning after December 31, 1995.

(3) The preference relating to bad debt losses of financial institutions would be repealed for taxable years beginning after December 31, 1995.

(4) In the case of a corporation, the preference relating to tax-exempt interest on private activity bonds would be repealed for interest accruing after December 31, 1995.

In addition, the special rules relating to tax shelter farm activity and passive losses would be repealed for taxable years beginning after December 31, 1995.

### **Adjustments in computing AMTI**

The provision would make the following changes to the adjustments used in computing AMTI:

(1) The adjustment relating to depreciation would be repealed for property placed in service after March 13, 1995. Under another proposed provision, property to which the proposed neutral cost recovery system applies would not be subject to the alternative minimum tax depreciation adjustment. The neutral cost recovery system generally would apply to qualified property placed in service after December 31, 1994, unless the taxpayer irrevocably elects, on a property-by-property basis, to not have the system apply.

(2) The adjustment relating to mining exploration and development costs would be repealed for costs paid or incurred after December 31, 1995.

(3) The adjustment relating to long-term contracts would be repealed for contracts entered into after December 31, 1995.

(4) The adjustment relating to pollution control facilities would be repealed for property placed in service after December 31, 1995.

(5) The adjustment relating to installment sales would be repealed for dispositions after December 31, 1995.

(6) The adjustments relating to circulation and research and experimental expenditures would be repealed for costs paid or incurred after December 31, 1995.

(7) The adjustment relating to Merchant Marine capital construction funds would be repealed for deposits made to a fund after December 31, 1995, and to earnings received or accrued after December 31, 1995, on amounts in such funds. Withdrawals of deposits and earnings from a fund after December 31, 1995, would be treated as allocable: (a) first to deposits (and earnings received or accrued) before January 1, 1987; (b) then, to deposits (and earnings received or accrued) after December 31, 1986, and before January 1, 1996; and (c) then, to deposits (and earnings received or accrued) after December 31, 1995.

(8) The denial of the special deduction allowed under section 833(b) would be repealed for taxable years beginning after December 31, 1995.

### **Adjusted current earnings (ACE) adjustment**

The provision would make the following changes to the ACE adjustment of the corporate alternative minimum tax:

(1) The ACE rules relating to the inclusion (or deduction) of items included (or excluded) from the calculation of earnings and profits would not apply to taxable years beginning after December 31, 1995.

(2) The ACE adjustment relating to intangible drilling costs would be repealed for amounts paid or incurred after December 31, 1995.

(3) The ACE adjustment relating to section 173 and 248 costs would be repealed for amounts paid or incurred after December 31, 1995.

(4) The ACE adjustment relating to LIFO inventory would be repealed for LIFO adjustments arising in taxable years beginning after December 31, 1995.

(5) The ACE adjustment relating to installment sales would be repealed for sales after December 31, 1995.

(6) The ACE adjustment relating to the exchange of debt pools would be repealed for exchanges after December 31, 1995.

(7) The ACE adjustment relating to built-in losses with respect to certain changes of ownership would be repealed for ownership changes after December 31, 1995.

(8) The ACE adjustments relating to section 173 and 248 costs would be repealed for amounts paid or incurred after December 31, 1995.

(9) The ACE adjustment relating to depletion would be repealed for depletion allowed in taxable years beginning after December 31, 1995.

#### **Use of credits**

The special rules relating to the use of net operating losses and foreign tax credits would be repealed for net operating losses and foreign tax credits used in taxable years beginning after December 31, 1995. Carrybacks of losses and credits to taxable years beginning before January 1, 1996, would continue to be subject to the 90 percent limitations.

The provision would not change the rules regarding the availability of other credits against the alternative minimum tax.

For taxable years beginning after December 31, 1995, a taxpayer with alternative minimum tax credit carryovers would be allowed to use these credits to offset 90 percent of its regular tax liability (determined after the application of other credits). As under present law, in no event could alternative minimum tax credit carryovers be used to reduce the taxpayer's tax liability below its tentative minimum tax, if any.

#### **Effective Date**

Except as provided above, the provision would be effective for taxable years beginning after December 31, 1995.

## **D. Public Debt Reduction Checkoff and Trust Fund**

### **Present Law**

The Presidential Election Campaign Fund ("Campaign Fund") provides for public financing of a portion of qualified Presidential election campaign expenditures and certain convention costs (sec. 9001 et seq.) The Campaign Fund is financed through the voluntary designation by individual taxpayers on their Federal income tax returns of \$3 of tax liability, which is commonly known as the Presidential election campaign checkoff (sec. 6096). This checkoff can be made only by individuals (not corporations) and does not affect the individual's tax liability.<sup>23</sup> The Treasury Department accumulates revenues in the Campaign Fund over a four-year period and then disburses funds to eligible candidates for President, Vice President, and conventions during the Presidential election year.<sup>24</sup>

Individuals who itemize deductions (as well as corporations) are allowed a deduction, subject to certain limitations, for contributions made to qualified charitable organizations or to Federal, State, and local governments. Instructions to IRS income tax forms inform taxpayers that they may make a gift to the Federal Government to reduce the public debt by enclosing with their return a separate check made payable to the "Bureau of Public Debt." In addition, various public laws provide that contributions to specific Federal entities or programs are regarded as gifts to the United States. Such contributions to the Bureau of Public Debt and to specific Federal entities or programs are deductible if the donor itemizes deductions for the year in which the contribution is made.

### **Description of Provision**

Individual taxpayers would be allowed to designate an amount up to 10 percent of their Federal income tax liability for a taxable year to be earmarked to reduce the Federal public debt. Such a designation could be made only at the time the taxpayer files his or her income tax return for a particular taxable year. An individual's decision whether or not to make a designation under the provision would not affect his or her tax liability. If an individual has no Federal income tax liability

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<sup>23</sup> Prior to enactment of the Revenue Reconciliation Act of 1993, individuals could designate \$1 of their Federal income tax liability to the Campaign Fund. For calendar year 1992, 20.5 million returns, or 18 percent of the total number of individual income tax returns, designated a total of \$29.6 million in contributions to the Campaign Fund. See Statement of Maurice B. Foley, Deputy Tax Legislative Counsel (Tax Legislation), Department of the Treasury, before the Ways and Means Subcommittee on Select Revenue Measures, U.S. House of Representatives, November 16, 1993.

<sup>24</sup> A number of States provide checkoffs on their income tax forms to permit taxpayers to fund State electoral campaigns, private charitable organizations, and State governmental programs. Some of the State programs require taxpayers to pay additional amounts to exercise the checkoff option, generally by accepting a smaller refund.

for a taxable year--i.e., the individual owes no Federal income tax after claiming allowable credits (other than the EITC) and any designation to the Presidential Election Campaign Fund--then such individual would not be allowed to make a designation to reduce the Federal debt on his or her return for that year.

Under the provision, amounts earmarked by taxpayers to reduce the public debt would be transferred into a Public Debt Reduction Trust Fund, which would be used only to retire or purchase Federal securities (other than obligations held by the Social Security Trust Fund, the Civil Service Retirement and Disability Fund, and the Department of Defense Military Retirement Fund). Related provisions (outside the jurisdiction of the committee and, thus, not included in the provision) would require either specific spending cuts or an across-the-board sequestration in Federal spending (with certain exceptions) to match the amounts designated by taxpayers for debt reduction.

#### **Effective Date**

The provision would be effective for taxable years ending after the date of enactment, and would remain in effect until the entire outstanding Federal public debt is retired.

## **E. Small Business Incentives**

### **1. Increase in unified estate and gift tax credits**

#### **Present Law**

##### **Application of the estate and gift tax**

A gift tax is imposed on lifetime transfers and an estate tax is imposed on transfers at death. Since 1976, the gift tax and the estate tax have been unified so that a single graduated rate schedule applies to cumulative taxable transfers made by a taxpayer during his or her lifetime and at death.<sup>25</sup> Under this rate schedule, the unified estate and gift tax rates begin at 18 percent on the first \$10,000 in cumulative taxable transfers and reach 55 percent on cumulative taxable transfers over \$3 million.

The amount of gift tax payable for any calendar year generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative lifetime taxable transfers made by the taxpayer and then subtracting any gift taxes payable for prior taxable periods. This amount is reduced by any available unified credit (and other applicable credits) to determine the gift tax liability for the taxable period.

The amount of estate tax payable generally is determined by multiplying the applicable tax rate (from the unified rate schedule) by the cumulative post-1976 taxable transfers made by the taxpayer during his lifetime or at death and then subtracting any gift taxes payable for prior calendar years (after 1976). This amount is reduced by any available unified credit (and other applicable credits) to determine the estate tax liability.

##### **Unified credit**

A unified credit is available with respect to taxable transfers by gift and at death. Since 1987, the unified credit amount has been fixed at \$192,800, which effectively exempts a total of \$600,000 in cumulative taxable transfers from the estate and gift tax. The benefits of the unified credit (and the graduated estate and gift tax rates) are phased-out by a five-percent surtax imposed upon cumulative taxable transfers over \$10 million and not exceeding \$21,040,000.<sup>26</sup>

The unified credit originally was enacted in the Tax Reform Act of 1976. As enacted, the credit was phased in over five years to a level that effectively exempted \$175,625 of taxable transfers from the estate and gift tax in 1981 (i.e., a unified credit of \$47,000). The Economic Recovery Tax Act of 1981 increased the amount of the unified credit each year between 1982 and 1987, from an

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<sup>25</sup> Prior to 1976, separate tax rate schedules applied to the gift tax and the estate tax.

<sup>26</sup> Thus, if a taxpayer has made cumulative taxable transfers exceeding \$21,040,000, his or her average transfer tax rate will be 55 percent under present law.

effective exemption of \$225,000 in 1982 to an effective exemption of \$600,000 in 1987. The unified credit has not been increased since 1987.

### **Annual exclusion for gifts**

A taxpayer may exclude \$10,000 of gifts made to any one donee during a calendar year. This annual exclusion does not apply to gifts of future interests (e.g., reversions or remainders). Prior to 1982, the annual exclusion was \$3,000.

### **Special use valuation**

Generally, for Federal transfer tax purposes, the value of property is its fair market value, i.e., the price at which the property would change hands between a willing buyer and a willing seller, neither being under any compulsion to buy or sell and both having reasonable knowledge of relevant facts. Under Code section 2032A, an executor may elect for estate tax purposes to value certain "qualified real property" used in farming or another qualifying closely-held trade or business at its current use value, rather than its highest and best use value. Presently, the maximum reduction in the value of such real property resulting from an election under Code section 2032A is \$750,000.

### **Generation-skipping transfer tax**

A generation-skipping transfer tax (GST tax) generally is imposed on transfers, either directly or through a trust or similar arrangement, to a "skip person" (i.e., a beneficiary in a generation more than one generation below that of the transferor). Transfers subject to the GST tax include direct skips, taxable terminations and taxable distributions.<sup>27</sup>

A person is allowed an exemption from the GST tax of up to \$1,000,000 for generation-skipping transfers made during life or at death.

### **Installment payment of estate tax**

Under Code section 6166, an executor generally may elect to pay the Federal estate tax attributable to an interest in a closely held business in installments over, at most, a 14-year period. To qualify for the election, the business must be an active trade or business and the value of the decedent's interest in the closely held business must exceed 35 percent of the decedent's adjusted

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<sup>27</sup> For this purpose, a direct skip is any transfer subject to estate or gift tax of an interest in property to a skip person (e.g., a gift from grandparent to grandchild). A taxable termination is a termination (by death, lapse of time, release of power, or otherwise) of an interest in property held in trust unless, immediately after such termination, a non-skip person has an interest in the property, or unless at no time after the termination may a distribution (including a distribution upon termination) be made from the trust to a skip person. A taxable distribution is a distribution from a trust to a skip person (other than a taxable termination or a direct skip).

gross estate.

If an election is made, the estate pays only interest for the first four years, followed by up to ten annual installments of principal and interest. Interest is generally imposed at the rate applicable to underpayments of tax under Code section 6621 (i.e., the Federal short term rate plus three percentage points). Under Code section 6601(j), however, a special four-percent interest rate applies to the amount of deferred estate tax attributable to the first \$1,000,000 in value of the closely-held business. The maximum amount that may be subject to the four-percent rate is the lower of (1) \$345,800 (i.e., the amount of estate tax on the first \$1,000,000), less the amount of allowable unified credit, or (2) the amount of estate tax attributable to the closely-held business that is being paid in installments pursuant to Code section 6166.

### **Description of Provision**

The provision would increase the present-law unified credit of \$192,800 to \$248,300 over a three-year period beginning in 1996. For decedents dying and gifts made in 1996, the unified credit would be \$229,800 (i.e., the amount that would effectively exempt \$700,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made in 1997, the unified credit would be \$239,050 (i.e., the amount that would effectively exempt \$725,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made after 1997, the unified credit would be \$248,300 (i.e., the amount that would effectively exempt \$750,000 in taxable transfers from the estate and gift tax). After 1998, the unified credit would be indexed for inflation each year by multiplying the applicable exclusion amount of \$750,000 by a cost of living adjustment. The indexed exclusion amount would be rounded to the nearest \$10,000.

Conforming amendments to reflect the increased unified credit would be made (1) to the five-percent surtax in order to permit the proper phase out of the increased unified credit, (2) to the general filing requirements for estate and gift tax returns under Code section 6018(a), and (3) to the amount of the unified credit allowed under Code section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

In addition to increasing and indexing the unified credit, the provision would index the following amounts for inflation beginning after 1998: (1) the \$10,000 annual exclusion for gifts; (2) the \$750,000 ceiling amount on special use valuation under Code section 2032A; (3) the \$1,000,000 generation-skipping transfer tax exemption; and (4) the value of a closely-held business (i.e., \$1,000,000) eligible for the special four-percent interest rate under Code section 6601(j). Indexing of the annual exclusion would be rounded to the nearest \$1,000 and indexing of the other amounts would be rounded to the nearest \$10,000.

### **Effective Date**

The provision would apply to the estates of decedents dying, and gifts made, after December 31, 1995.

## 2. Increase in expensing for small businesses

### Present Law

In lieu of depreciation, a taxpayer with a sufficiently small amount of annual investment may elect to deduct up to \$17,500 of the cost of qualifying property placed in service for the taxable year (sec. 179).<sup>28</sup> In general, qualifying property is defined as depreciable tangible personal property that is purchased for use in the active conduct of a trade or business. The \$17,500 amount is reduced (but not below zero) by the amount by which the cost of qualifying property placed in service during the taxable year exceeds \$200,000. In addition, the amount eligible to be expensed for a taxable year may not exceed the taxable income of the taxpayer for the year that is derived from the active conduct of a trade or business (determined without regard to this provision). Any amount that is not allowed as a deduction because of the taxable income limitation may be carried forward to succeeding taxable years (subject to similar limitations).

### Description of Provision

The provision would increase the \$17,500 amount allowed to be expensed under Code section 179 to \$35,000. The increase would be phased in as follows:

<u>Maximum Expensing</u>	<u>Taxable Year</u>
\$22,500	1996
\$27,500	1997
\$32,500	1998
\$35,000	1999

### Effective Date

The provision would be effective for property placed in service in taxable years beginning after December 31, 1995, subject to the phase-in schedule set forth above.

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<sup>28</sup> The amount permitted to be expensed under Code section 179 is increased by up to \$20,000 for certain property placed in service by a business located in an empowerment zone (sec. 1397A).

### **3. Clarification of definition of principal place of business; Treatment of storage of product samples**

#### **Present Law**

A taxpayer's business use of his or her home may give rise to a deduction for the business portion of expenses related to operating the home (e.g., a portion of rent or depreciation and repairs). Code section 280A(c)(1) provides, however, that business deductions generally are allowed only with respect to a portion of a home that is used exclusively and regularly in one of the following ways: (1) as the principal place of business for a trade or business; (2) as a place of business used to meet with patients, clients, or customers in the normal course of the taxpayer's trade or business; or (3) in connection with the taxpayer's trade or business, if the portion so used constitutes a separate structure not attached to the dwelling unit. In the case of an employee, the Code further requires that the business use of the home must be for the convenience of the employer (sec. 280A(c)(1)).<sup>29</sup> These rules apply to houses, apartments, condominiums, mobile homes, boats, and other similar property (sec. 280A(f)(1)). Under Internal Revenue Service (IRS) rulings, the deductibility of expenses incurred for local transportation between a taxpayer's home and a work location sometimes depends on whether the taxpayer's home office qualifies under section 280A(c)(1) as a principal place of business (see Rev. Rul. 94-47, 1994-29 I.R.B. 6).

Prior to 1976, expenses attributable to the business use of a residence were deductible whenever they were "appropriate and helpful" to the taxpayer's business. In 1976, Congress adopted section 280A, in order to provide a narrower scope for the home office deduction, but did not define the term "principal place of business." In Commissioner v. Soliman, 113 S.Ct. 701 (1993), the Supreme Court reversed lower court rulings and upheld an IRS interpretation of section 280A that disallowed a home office deduction for a self-employed anesthesiologist who practiced at several hospitals but was not provided office space at the hospitals. Although the anesthesiologist used a room in his home exclusively to perform administrative and management activities for his profession (i.e., he spent two or three hours a day in his home office on bookkeeping, correspondence, reading medical journals, and communicating with surgeons, patients, and insurance companies), the Supreme Court upheld the IRS position that the "principal place of business" for the taxpayer was not the home office but, rather, was at the hospitals where he performed the "essence of the professional service."<sup>30</sup>

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<sup>29</sup> If an employer provides access to suitable space on the employer's premises for the conduct by an employee of particular duties, then, if the employee opts to conduct such duties at home as a matter of personal preference, the employee's use of the home office is not "for the convenience of the employer." See, e.g., W. Michael Mathes, (1990) T.C. Memo 1990-483.

<sup>30</sup> In response to the Supreme Court's decision in Soliman, the IRS revised its Publication 587, Business Use of Your Home, to more closely follow the comparative analysis used in Soliman by focusing on the following two primary factors in determining whether a home office is a taxpayer's principal place of business: (1) the relative importance of the activities performed at each business location; and (2) the amount of time spent at each location.

Because the taxpayer did not meet with patients at his home office and the room was not a separate structure, a deduction was not available under the second or third exception under section 280A(c)(1) (described above).

Section 280A(c)(2) contains a special rule that allows a home office deduction for business expenses related to a space within a home that is used on a regular (even if not exclusive) basis as a storage unit for the inventory of the taxpayer's trade or business of selling products at retail or wholesale, but only if the home is the sole fixed location of such trade or business.

Home office deductions may not be claimed if they create (or increase) a net loss from a business activity, although such deductions may be carried over to subsequent taxable years (sec. 280A(c)(5)).

### **Description of Provision**

The provision would amend present-law section 280A to specifically provide that a home office qualifies as the "principal place of business" if (1) the office is used by the taxpayer to conduct administrative or management activities for a trade or business and (2) there is no other fixed location of the trade or business where the taxpayer conducts substantial administrative or management activities. As under present law, deductions would be allowed for a home office meeting the above two-part test only if the office is exclusively used on a regular basis as a place of business by the taxpayer, and in the case of an employee, only if such exclusive use is for the convenience of the employer.

Thus, under the provision, a home office deduction would be allowed (subject to the present-law "convenience of the employer" rule governing employees) if a portion of a taxpayer's home is exclusively and regularly used to conduct administrative or management activities for a trade or business of the taxpayer, who does not conduct substantial administrative or management activities at any other fixed location of the trade or business, regardless of whether administrative or management activities connected with his trade or business (e.g., billing activities) are performed by others at other locations. The fact that a taxpayer also carried out administrative or management activities at sites that were not fixed locations of the business, such as a car or hotel room, would not affect the taxpayer's ability to claim a home office deduction. Moreover, if a taxpayer conducts some administrative or management activities at a fixed location of the business outside the home, the taxpayer still would be eligible to claim a deduction so long as the administrative or management activities conducted at any fixed location of the business outside the home were not substantial (e.g., the taxpayer occasionally does minimal paperwork at another fixed location of the business). In addition, a taxpayer's eligibility to claim a home office deduction under the provision would not be affected by the fact that the taxpayer conducts substantial non-administrative or non-management business activities at a fixed location of the business outside the home.

In addition, the provision would clarify that the special rule contained in present-law section 280A(c)(2) permits deductions for expenses related to a storage unit in a taxpayer's home regularly

used for inventory or product samples (or both) of the taxpayer's trade or business of selling products at retail or wholesale, provided that the home is the sole fixed location of such trade or business.

**Effective Date**

The provision would apply to taxable years beginning after 1995.

## **IV. FAMILY REINFORCEMENT TAX ACT (TITLE IV)**

### **A. Tax Credit for Adoption Expenses**

#### **Present Law**

Present law does not provide a tax credit for adoption expenses. The Federal Adoption Assistance program (a Federal outlay program) provides financial assistance for the adoption of certain special needs children. In general, a special needs child is defined as a child who (1) according to a State determination, could not or should not be returned to the home of the natural parents and (2) could not reasonably be expected to be adopted unless adoption assistance is provided, on account of a specific factor or condition (such as ethnic background, age, membership in a minority or sibling group, medical condition, or physical, mental or emotional handicap). Specifically, the program provides assistance for adoption expenses for those special needs children receiving Federally assisted adoption assistance payments as well as special needs children in private and State funded programs. The maximum Federal reimbursement is \$1,000 per special needs child. Reimbursable expenses include those associated directly with the adoption process such as legal costs, social service review, and transportation costs.

#### **Description of Provision**

The provision would provide taxpayers with a maximum nonrefundable tax credit of \$5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Qualified adoption expenses would be reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to, and the principal purpose of which, are the legal adoption of an eligible child. An eligible child would be an individual: (1) who has not attained age 18 on the date the adoption becomes final, or (2) who is physically or mentally incapable of caring for himself or herself. No credit would be allowed for expenses incurred in violation of State or Federal law, any surrogate parenting arrangement, or the adoption of a child of the taxpayer's spouse. The credit would be phased out ratably for taxpayers with adjusted gross income (AGI) above \$60,000 and would be fully phased out at \$100,000 of AGI. For purposes of this AGI test, the taxpayer's AGI would be increased by the amount otherwise excluded from gross income under Code sections 911, 931, or 933 (relating to the exclusion of income of U.S. citizens or residents living abroad; residents of Guam, American Samoa, and the Northern Mariana Islands, and residents of Puerto Rico, respectively).

To avoid a double benefit, the provision would deny the credit to taxpayers to the extent the taxpayer may use otherwise qualified adoption expenses as the basis of another credit or deduction. Also, the credit would not be allowed for any expenses for which a grant is received under any Federal, State, or local program except in the case of special needs children. The provision would provide that couples who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the child for more than one-half of the

taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Finally, the provision would provide that an individual legally separated from his spouse under a decree of divorce or separate maintenance would not be considered married.

**Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## **B. Nonrefundable Credit for Custodial Care of Certain Elderly Family Members in Taxpayer's Home**

### **Present Law**

Generally, present law does not provide for tax credits based solely on custodial care of parents or grandparents. However, taxpayers with dependent parents generally are able to claim a personal exemption for these dependents. The total amount of personal exemptions is subtracted (along with certain other items) from adjusted gross income (AGI) in arriving at taxable income. The amount of each personal exemption is \$2,500 for 1995, and is adjusted annually for inflation. The amount of the personal exemption is phased out for taxpayers with AGI in excess of \$114,700 for single taxpayers, \$143,350 for heads of household, and \$172,050 for married couples filing joint returns.

### **Description of Provision**

The provision would provide taxpayers who maintain a household including one or more "qualified persons" with a maximum nonrefundable credit of \$500 for each qualified person.

To be a "qualified person," an individual would have to pass a relationship test, a residency test and a disability test. The individual would satisfy the relationship test if the individual is the father or mother of: (a) the taxpayer, (b) the taxpayer's spouse or (c) a former spouse of the taxpayer. A stepfather, stepmother and ancestors of the father or mother would be treated as a father or mother for these purposes.

An individual would satisfy the residency test if the individual has the same principal place of abode as the taxpayer for more than one-half of the taxpayer's taxable year.

An individual would satisfy the disability test if the individual is physically or mentally incapable of caring for himself or herself.

The provision would provide that an individual would be treated as maintaining a household for any period only if over one-half of the cost of maintaining a household for such period is furnished by such individual or, if such individual is married, by such individual and his or her spouse. The provision would also provide that individuals who are married at the end of the taxable year must file a joint return to receive the credit unless they lived apart for the last six months of the taxable year and the individual claiming the credit (1) maintained as his or her home a household for the qualified person for more than one-half of the taxable year and (2) furnished over one-half of the cost of maintaining that household in that taxable year. Finally, the provision would provide that an individual legally separated from his or her spouse under a decree of divorce or of separate maintenance would not be considered married for purposes of this provision.

**Effective Date**

The provision would be effective for taxable years beginning after December 31, 1995.

## V. INCREASE IN THE SOCIAL SECURITY EARNINGS LIMIT (TITLE V)

### Present Law

Under present law, senior citizens age 70 and older receive full Social Security benefits regardless of the amount of earnings they have from wages or self employment. Senior citizens between age 65 and 69 are eligible for full benefits only if their earnings are lower than the earnings limit amount determined by law. In 1995, the annual earnings limit for those age 65 to 69 is \$11,280. The earnings limit amount is indexed and increases annually in proportion to the rate of average wage growth in the economy.

Senior citizens age 65 to 69 who earn more than the earnings limit lose \$1 in Social Security benefits for every \$3 in wages or self employment income they earn over the limit.

### Description of Provision

The provision would gradually raise the earnings limit for those age 65 to 69 to \$30,000 by the year 2000. The increase would be phased in over 5 years as follows:

<u>Year</u>	<u>Proposed earnings limit</u>
1996 .....	\$15,000
1997 .....	\$19,000
1998 .....	\$23,000
1999 .....	\$27,000
2000 .....	\$30,000

Senior citizens age 65 to 69 who earn over the given earnings limit for the year would continue to lose \$1 in benefits for every \$3 earned over the limit.

### Effective Date

The provision would be effective for taxable years beginning after 1995.

## VI. THE TAX TECHNICAL CORRECTIONS ACT OF 1995 (TITLE VI)

### Description of Provision

The provision would incorporate (with modifications) the "Tax Technical Corrections Act of 1995," previously introduced separately as H.R. 1121 by Chairman Archer and Mr. Gibbons on March 3, 1995. The provisions of this legislation are described in detail in the Joint Committee on Taxation pamphlet, *Explanation of the Tax Technical Corrections Act of 1995 (H.R. 1121)* (JCS-6-95), March 8, 1995.

H.R. 1121 would be modified, for purposes of this provision, by dropping two provisions ((1) section 2(a)(3) (relating to correction of head of household rate table for proper indexing) and (2) section 3(f)(1) (relating to treatment of certain nonqualified withdrawals from Merchant Marine capital construction funds)), and by adding new clerical corrections.