All Cong Doc Staff

DEPARTMENT OF THE TREASURY
WASHINGTON, D.C.
June 11, 1997

SECRETARY OF THE TREASURY

The Honorable Bill Archer
Chairman, Committee on Ways and Means
U.S. House of Representatives
Washington, DC 20515-4005

Dear Bill:

I have reviewed the Chairman's Mark you released earlier this week, providing the details of the tax portion of the bipartisan budget agreement. The President is eager to sign legislation implementing the agreement into law, but in its present form, the proposal you have put forth does not meet the test of fairness to working families and has other serious problems. Over 35 percent of the benefits from your tax cuts go to families with incomes in the top five percent of the income distribution, and 68 percent of the benefits go to families in the top 20 percent. I have included preliminary Treasury distribution tables for your package after this letter.

Your bill will reduce the value of the $500 child credit for millions of low income families by requiring a family to take the child credit only after the earned income tax credit is taken against their tax liability. A family with two children and $25,000 of income, for example, would receive no tax relief from the child credit under your proposal. Under the President's plan, this family would get $1,000, the same as a family that earned twice as much. We would favor a refundable child credit that better targets low and middle income working families. The credit should be indexed for inflation. We would also permit taxpayers to place their child credit into a tax-favored savings account to finance their children's college education. In combination with our tuition deduction, this proposal would allow families to save and pay for college tax-free.

The proposed legislation singles out six million families who pay for child care and gives them a smaller tax cut. Beginning in 2002, families who receive a tax credit for their child care expenses would lose 50 cents for each dollar of their child credit. This provision unfairly reduces tax relief for working parents who are struggling to maintain a decent standard of living and to pay for child care. For example, a family with two working parents making $45,000 who pay for child care for their two children would seemingly be eligible for a $1,000 child tax credit. But under the proposed legislation, they would also lose $480 of their child tax credit. Furthermore, because dependent care constitutes a cost of earning income, the child and dependent care credit should not be phased out.

The education package falls nearly $13 billion short of the agreed goal of $35 billion in tax cuts for education, which are consistent with the HOPE scholarship and tuition deduction proposals in the President's FY98 Budget. Furthermore, as compared to the President's proposals, it directs more benefits toward upper-income families while reducing the benefits to lower-income families. It introduces serious administrative complications and is less effective at easing the burden of college attendance for working families.

- The HOPE credit would be cut to 50 percent of tuition expenses, halving the value of education benefits for millions of students attending community colleges and other low-cost institutions.

- Unlike the broadly available tuition deduction in the President's package, the tuition deduction in your proposal would be available only if education expenses are paid from certain education savings plans. Hence, no help is given beyond the first two years of higher education to low-income students and students who must borrow to pay tuition. In addition, your proposal does much less to encourage lifelong learning, one of the central objectives of the President's package.

- Tax-free savings offered through new education investment accounts and the opportunities for tax-deferred saving through private prepaid tuition plans are overly generous to upper income families, since they have neither income limits nor contribution limits. This would give high-income taxpayers an incentive to use these vehicles to save tax-free, even if they never intend to use the savings for education expenses. In the early years, the benefits for education will only be available to those who already have large reserves of cash to deposit in these accounts, not to others who can contribute only modest amounts each year.

The American Dream IRAs are not sufficiently targeted. Contributions could be made to these back-loaded IRAs without any income limits, which would surely result in a substantial shifting of existing savings into tax-preferred investment vehicles by high-income taxpayers, rather than creating new savings.

The proposal to index certain capital assets and lower the rate of tax on capital gains provides a double benefit to taxpayers, substantially overcompensating them for the effects of inflation. The package would disproportionately benefit the wealthy over lower- and middle-income wage earners. The package also has an explosive revenue cost in years after 2007, possibly jeopardizing all our important work to balance the budget. In addition, the indexing proposal is enormously complex and difficult to administer. To quote the New York State Bar Association, indexing is "fundamentally flawed" and would create problems that would "overwhelm taxpayers and the IRS."

We want a capital gains tax cut that will help the economy and will not explode in cost. Therefore, we propose an expansion of the existing exclusion for long-term equity investments in smaller businesses. The expansion of the capital gains incentive for small businesses will help more start-ups get off the ground, and ensure that America continues to lead the world in high technology.

At a time when business conditions are strong and profits are at their highest shared of GDP in two decades, you have proposed to spend $34 billion over 10 years to eliminate the corporate alternative minimum tax. This provision would return us to the days when some of the largest and most profitable corporations paid zero income taxes.

Your plan contains other provisions that raise serious concerns. The safe-harbor for independent contractor status would permit employers to avoid essential worker protections. At a time when we are trying to expand health and pension coverage, this proposal could lead to widespread shifting of employees to independent contractor status, resulting in loss of worker protections such as pension and health coverage, and consequently wage and hour protections, unemployment insurance benefits and compensation for work-related injuries.

Under your proposal, Indian tribes would be subject to the unrelated business income tax on all income earned from commercial activities. Contrary to long-established U.S. policy, this tax fails to respect the sovereignty of Indian tribes and their special status as domestic dependent nations. This lack of respect for sovereignty is particularly apparent in the difference the proposal would create between tribes and States. In addition, the proposal would be extremely difficult to administer.

We are very disappointed that your proposal excluded a number of important initiatives for the President's FY 1998 Budget that were included in the budget agreement. For example, the Nation's mayors and urban and rural communities have been extremely supportive of the President's brownfields provision, which provides a tax incentive for environmental cleanup and encourages economic development in formerly contaminated areas. Your proposal excludes this provision. And while tax relief is provided for the District of Columbia, no additional Empowerment Zones or Enterprise Communities for the rest of the country are provided.

In addition, no provision is included to stimulate investments in Community Development Financial Institutions to revitalize distressed neighborhoods around the country. No provision is included for equitable tolling, which protects a taxpayer's rights when he or she is incapacitated, or for restructuring our Nation's affordable housing portfolio.

Your bill also includes a provision to raise the debt ceiling. We believe that it should be included in the other reconciliation bill.

In summary, we think this package disproportionately benefits the most well off in society at the expense of working families. Given the tough choices that need to be made within this tax package, we think it is unwise, for example, to eliminate the corporate AMT, while at the same time denying tax relief provided by the child credit to millions of hard-working taxpayers with children who receive the earned income tax credit. Moreover, the provisions in the package that drive up costs beyond the ten year budget window, are those that most advantage high-income taxpayers.

We look forward to working with the Congress to design a tax package that helps working families pay for education, buy and sell homes, and raise their children. We are committed to achieving a tax package that is fair to all Americans.

Sincerely,

Robert E. Rubin

Attachments

President Delivers First Balanced Budget Agreement in a Generation

Historic Agreement Promotes the Country's Values and Priorities

May 16, 1997

President Clinton has achieved a balanced budget agreement that promotes our values, providing critical funding for education, health care, and the environment while strengthening and modernizing Medicare and Medicaid. We have cut the deficit by 77%, from $290 billion in 1992 to roughly $67 billion this year. This historic achievement will finish the job, while meeting the President's goals.

GOAL: To achieve the first balanced budget in a generation.

- ✔ Budget balances by 2002 -- for the first time since 1969.
- ✔ Saves over $200 billion over five years and over $900 billion over ten years.

GOAL: To ensure that every 8 year-old can read, every 12 year-old can log on to the Internet, and every 18 year-old can go to college.

- ✔ A child literacy initiative consistent with the President's America Reads challenge to help children learn to read well and independently by the end of the third grade.
- ✔ Expands Head Start to 1998 level in the President's budget, which assumes path to one million kids in 2002.
- ✔ Fully funds Technology Literacy Challenge Fund with at least $425 million in FY 98.
- ✔ Largest single increase in higher education since the G.I. Bill in 1945.
- ✔ Provides largest Pell Grant increase in two decades -- four million students could receive a grant of up to $3,000, an increase of $300 in the maximum grant.
- ✔ $35 billion of tax cuts targeted to higher education to make college more affordable for America's families, consistent with the President's HOPE Scholarship and tuition tax deduction.
- ✔ Adopts President's full training and employment budget, including Job Corps.

GOAL: Expand health coverage for as many as 5 million uninsured children.

- ✔ Provides $16 billion for children's health care, including Medicaid improvements and investments, and/or a new capped mandatory grant program that supplements states' efforts to cover uninsured children in working families.

GOAL: Secure and strengthen Medicare and Medicaid.

- ✔ Extends the Medicare Trust Fund at least a decade through long overdue structural reforms.
- ✔ Expands coverage of critical preventive treatments of diseases such as diabetes and helps detect breast cancer and colon cancer earlier.
- ✔ Preserves the federal Medicaid guarantee of coverage to our nation's most vulnerable people.

GOAL: Strengthen environmental protection and enforcement.

- ✔ Provides $3.4 billion in 1998 -- a 9% increase over 1997 -- for EPA operations, research, and enforcement programs to protect public health from environmental threats.
- ✔ Provides funding to cover the expansion of the Brownfield Redevelopment Initiative to help communities cleanup and redevelop contaminated areas.
- ✔ Likely to double the pace of Superfund cleanups -- 500 additional sites cleaned up by the end of 2000.

GOAL: Move people from welfare to work and treat legal immigrants fairly.

- ✔ A Welfare-to-Work tax credit to help long-term welfare recipients to get jobs.
- ✔ Provides funding to preserve food stamp benefits for people willing to work.
- ✔ Provides $3 billion to states and localities to move recipients in disadvantaged areas into jobs.
- ✔ Restores $10 billion in disability and health benefits for legal immigrants.

GOAL: Cut taxes for America's hard working families.

- ✔ A Child Tax Credit to make it easier for families to raise their kids.
- ✔ $35 billion of tax cuts targeted to higher education to make college more affordable
- ✔ A Welfare-to-Work tax credit to help long-term welfare recipients get jobs.
- ✔ Establishes additional Empowerment Zones and Enterprise Communities.

Summary of Budget Savings

President Clinton has achieved a balanced budget agreement that provides funding for critical investments in education, health care, and the environment while strengthening and modernizing Medicare and Medicaid -- just as he promised last year. We have cut the deficit 77% -- from $290 billion in 1992 to an expected $67 billion this year. This historic achievement will finish the job, giving the American people the first balanced budget in a generation, while meeting the President's goals:

- ✔ ***The First Balanced Budget in a Generation.***
- ✔ ***Saves over $200 Billion over 5 Years & over $900 Billion over 10 Years.***
- ✔ ***Largest Increase in Education Funding in 30 Years - including $35 billion in tax cuts to make college more affordable.***
- ✔ ***Entitlement Savings of Nearly a Half Trillion Dollars over 10 Years.***
- ✔ ***Strengthens and Modernizes Medicare -- extending the life of the Trust Fund more than a decade through long overdue structural reforms.***
- ✔ ***Expanded Health Coverage for as many as 5 Million Children.***

BUDGET AGREEMENT SAVINGS		
AREA	5 Year Savings 1998-2002 ($ billion)	10 Year Savings 1998-2007 ($billion)
Discretionary Spending		
Defense	-77	-247
Nondefense	-61	-273
Subtotal	-138	-520
Mandatory Spending		
Medicare	-115	-434
Medicaid	-14	-66
Other	-40	-60
Subtotal	-168	-560
Net Interest	-14	-142
Gross Savings	-320	-1,221
Initiatives		
Children's Health	16	39
Welfare Reform	14	23
Tax Cut	85	250
Net Savings	-204	-906

FACT SHEET ON THE BUDGET AGREEMENT
May 16, 1997

DEFICIT REDUCTION

- **First balanced budget in a generation.** Budget balances by 2002 -- for the first time since 1969.

- **Finishes the job.** The 1993 Economic Plan has already reduced the deficit 77%, from $290 billion in 1992 to an expected $67 billion this year. This budget agreement finishes the job, balancing the budget by 2002 -- with $204 billion in net budget savings over the next 5 years.

- **Keeps budget balanced through 2007.** The agreement will maintain budget balance until 2007, and save $906 billion over the next 10 years.

CONSERVATIVE ASSUMPTIONS

- **Proven record on forecasts.** For four years in a row, growth has been higher and the deficit has been lower than predicted. For example, CBO predicted growth for 1996 of 2.0 percent and the Administration predicted 2.2 percent. Actual growth was 2.4 percent. CBO forecast a deficit of $197 billion, and the Administration forecast a deficit of $211 billion. The actual deficit was $107 billion.

- **Conservative assumptions.** The assumptions used in this agreement are similarly conservative. The real growth assumption over the next 5 years (2.2 percent per year), for example, is lower than the Blue Chip private sector consensus (2.3 percent). It is intended to reflect average growth over different stages of the business cycle. Since 1973, over several business cycles, growth has averaged 2.6 percent per year.

- **80% of the $225 billion in additional CBO revenue either already assumed or used for deficit reduction.** The majority of the $225 billion adjustment had already been assumed in the budget negotiations.

DISCRETIONARY SPENDING

- **Budget agreement achieves 99% of the President's budget for non-defense discretionary spending over the next 5 years.** $61 billion of savings in non-defense discretionary outlays over the next 5 years -- a 10% real cut by 2002. $77 billion of savings in defense spending over the next 5 years -- an 11% real cut by 2002.

TAX CUTS

- **$85 billion in net tax cuts.** $85 billion in net tax cuts over the next 5 years and $250 billion in net tax cuts over the next 10 years.

- **$35 billion for the President's education tax proposals.** The agreement includes a commitment to provide roughly $35 billion over 5 years for post-secondary education, including a deduction and tax credit.

- **Other commitments.** The agreement commits the House and Senate Leadership to seek approval of various proposals, including:

  -- $500 per child tax credit
  -- The welfare-to-work tax credit
  -- Capital gains tax relief for home sales
  -- The Administration's EZ/EC proposals
  -- Tax relief for brownfields legislation
  -- Tax relief for FSC software
  -- Tax incentives to spur DC growth

ENTITLEMENT SAVINGS

- **Extends life of Medicare Trust Fund for more than a decade.** Contains Medicare savings of $115 billion over 5 years including payment reductions and long overdue structural reforms, extending the life of the Trust Fund for at least a decade. Helps protect the Medicare Part A Trust Fund by reallocating a portion of home health care costs to Part B and phasing in these costs over 7 years into the Part B premium.

- **Modernizes Medicare.** Modernizes Medicare by:

  -- Increasing the number of health plan options such as preferred provider organizations and provider sponsored organizations;
  -- Implementing a new prospective payment system for skilled nursing home facilities, home health, and hospital outpatient departments; and
  -- Increasing financial incentives for managed care plans in rural communities.

- **New Medicare improvements.** Establishing new benefits including: helping detect breast cancer, colon cancer, and helping manage diabetes; and reducing excessively high outpatient hospital coinsurance.

- **Reforms Medicaid while maintaining Federal guarantee.** Medicaid savings of $13.6 billion through reductions in DSH payments and increased state flexibility, while maintaining the Federal guarantee. Setting aside $1.5 billion for low-income protections to help ease the impact of Medicare premiums.

CHILDREN'S HEALTH CARE

- Invests $16 billion to expand health care coverage to as many as 5 million children through one or both of the following: expanding Medicaid coverage by improving outreach initiatives and adding new options for coverage and/or a capped mandatory grant program.

EDUCATION

- **Largest increase in education investment in 30 years.**

- **Fully Funds Education and Training.** Adopts the President's FY 1998 request for discretionary education and training programs.

- **Higher Education Tax Cuts.** Provides roughly $35 billion over five years for postsecondary education tax cuts consistent with the President's HOPE Scholarship and tax deduction proposals.

- **Largest Pell Grant Expansion in Two Decades.** Increases the maximum Pell Grant for low-income college students to $3,000 -- the largest increase in two decades. Provides a $1.7 billion increase in funding -- a 25% increase in FY 1998.

- **America Reads Challenge.** Adopts the President's budget request to launch a child literacy initiative consistent with his America Reads program.

WELFARE TO WORK

- **Fully funds the President's welfare-to-work jobs initiative.** Adds $3 billion, the full amount requested by the President for the Welfare-to-Work Jobs Challenge, to the TANF block grant to fund welfare-to-work efforts in high-poverty, high-unemployment areas. A share of the funding will go to cities and counties with large numbers of people in poverty.

- **Preserves food stamps for people willing to work.** Provides $750 million to create additional work slots for able-bodied unemployed childless adults subject to the time limit on food stamps. Also allows States to exempt a limited number of persons falling into this category who are willing to work but would otherwise be ineligible for food stamps.

- **Welfare-to-work tax credit.** The President and the Congressional leadership have agreed to seek a welfare to work tax credit to encourage employers to give welfare recipients the chance to work.

RESTORING BENEFITS TO LEGAL IMMIGRANTS

- **Benefits for legal immigrants.** Restores full SSI and Medicaid benefits for disabled legal immigrants currently receiving assistance; and for legal immigrants in the country prior to August 23, 1996 who are not now receiving benefits but subsequently become disabled.

ENVIRONMENT

- **EPA operations, enforcement, and research.** Provides a 9 percent increase, to $3.4 billion, for EPA's operating program -- which finances most of EPA's research, enforcement, and regulatory programs.

- **Doubles the pace of Superfund cleanups.** Pending agreement on detailed policies, adopts the President's proposals for Superfund cleanups of an additional 500 sites by the end of the year 2000.

- **Brownfields initiative.** Boosts funding by $75 million in 1998 to provide grants to communities for site assessment and development planning and to leverage state, local, and private funds to foster redevelopment.

- **National Parks.** Provides a 6 percent increase for operation of the National Parks, and an 89 percent increase ($234 million) for Everglades Restoration.