AUTHENTICATED
U.S. GOVERNMENT
INFORMATION
GPO

TAXES AS PART OF THE FEDERAL BUDGET

HEARING

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

ONE HUNDRED TENTH CONGRESS

SECOND SESSION

MARCH 23, 2010

Serial No. 111–44

Printed for the use of the Committee on Ways and Means

U.S. GOVERNMENT PRINTING OFFICE

63–076 WASHINGTON : 2010

For sale by the Superintendent of Documents, U.S. Government Printing Office
Internet: bookstore.gpo.gov Phone: toll free (866) 512–1800; DC area (202) 512–1800
Fax: (202) 512–2104 Mail: Stop IDCC, Washington, DC 20402–0001

COMMITTEE ON WAYS AND MEANS

SANDER M. LEVIN, Michigan, *Acting Chairman*

CHARLES B. RANGEL, New York
FORTNEY PETE STARK, California
JIM MCDERMOTT, Washington
JOHN LEWIS, Georgia
RICHARD E. NEAL, Massachusetts
JOHN S. TANNER, Tennessee
XAVIER BECERRA, California
LLOYD DOGGETT, Texas
EARL POMEROY, North Dakota
MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
EARL BLUMENAUER, Oregon
RON KIND, Wisconsin
BILL PASCRELL, JR., New Jersey
SHELLEY BERKLEY, Nevada
JOSEPH CROWLEY, New York
CHRIS VAN HOLLEN, Maryland
KENDRICK B. MEEK, Florida
ALLYSON Y. SCHWARTZ, Pennsylvania
ARTUR DAVIS, Alabama
DANNY K. DAVIS, Illinois
BOB ETHERIDGE, North Carolina
LINDA T. SÁNCHEZ, California
BRIAN HIGGINS, New York
JOHN A. YARMUTH, Kentucky

DAVE CAMP, Michigan
WALLY HERGER, California
SAM JOHNSON, Texas
KEVIN BRADY, Texas
PAUL RYAN, Wisconsin
ERIC CANTOR, Virginia
JOHN LINDER, Georgia
DEVIN NUNES, California
PATRICK J. TIBERI, Ohio
GINNY BROWN–WAITE, Florida
GEOFF DAVIS, Kentucky
DAVID G. REICHERT, Washington
CHARLES W. BOUSTANY, JR., Louisiana
DEAN HELLER, Nevada
PETER J. ROSKAM, Illinois

JANICE MAYS, *Chief Counsel and Staff Director*
JON TRAUB, *Minority Staff Director*

SUBCOMMITTEE ON SELECT REVENUE MEASURES

RICHARD E. NEAL, Massachusetts, *Chairman*

MIKE THOMPSON, California
JOHN B. LARSON, Connecticut
ALLYSON Y. SCHWARTZ, Pennsylvania
EARL BLUMENAUER, Oregon
JOSEPH CROWLEY, New York
KENDRICK B. MEEK, Florida
BRIAN HIGGINS, New York
JOHN A. YARMUTH, Kentucky

PATRICK J. TIBERI, Ohio, *Ranking Member*
JOHN LINDER, Georgia
DEAN HELLER, Nevada
PETER J. ROSKAM, Illinois
GEOFF DAVIS, Kentucky

Pursuant to clause 2(e)(4) of Rule XI of the Rules of the House, public hearing records of the Committee on Ways and Means are also, published in electronic form. **The printed hearing record remains the official version.** Because electronic submissions are used to prepare both printed and electronic versions of the hearing record, the process of converting between various electronic formats may introduce unintentional errors or omissions. Such occurrences are inherent in the current publication process and should diminish as the process is further refined.

CONTENTS

	Page
Advisory of March 16, 2010 announcing the hearing	2

WITNESSES

Thomas A. Barthold, Chief of Staff, Joint Committee on Taxation	8
Len Burman, Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School, Syracuse University, Center for Policy Research, Syracuse, New York	96
Robert Greenstein, Executive Director, Center on Budget and Policy Priorities, Washington, D.C.	112
Douglas Holtz-Eakin, President, American Action Forum, Arlington, Virginia	126

HEARING ON TAXES AS PART OF THE FEDERAL BUDGET

TUESDAY, MARCH 23, 2010

U.S. HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The Subcommittee met, pursuant to notice, at 2:00 p.m. in Room 1100 Longworth House Office Building, the Honorable Richard Neal [chairman of the Committee] presiding.

[The advisory of the hearing follows:]

HEARING ADVISORY

FROM THE COMMITTEE ON WAYS AND MEANS

Neal Announces Hearing on Taxes and the Federal Budget

March 16, 2010

By (202) 226–8933

House Ways and Means Select Revenue Measures Subcommittee Chairman Richard E. Neal (D–MA) announced today that the Subcommittee on Select Revenue Measures will hold a hearing on the role of taxes as part of the federal budget. **The hearing will take place on Tuesday, March 23, 2010, in the main Committee hearing room, 1100 Longworth House Office Building, beginning at 2:00 p.m.**

Oral testimony at this hearing will be limited to invited witnesses. However, any individual or organization not scheduled for an oral appearance may submit a written statement for consideration by the Committee and for inclusion in the printed record of the hearing.

FOCUS OF THE HEARING:

The hearing will focus on the outlook for federal tax revenues, including projections and estimates for extensions of major expiring provisions. The hearing will also explore the role of tax revenues in the federal budget as concerns grow about the rising budget deficits in both the short and long-term.

BACKGROUND:

Recently, the Congressional Budget Office (CBO) projected that the federal budget would show a deficit of $1.3 trillion for 2010, and that federal deficits were projected to average about $600 billion per year over 2011–2020 (CBO, "The Budget and Economic Outlook: Fiscal Years 2010 to 2020," January 2010). According to CBO, its baseline projection could understate the budget deficits because it assumes major tax cuts from 2001, 2003, and 2009 would expire as scheduled and that protection from the impact of the Alternative Minimum Tax (AMT) would not be extended, as it has been in prior years. CBO's baseline projections show revenues rising to 20.2 percent of GDP (gross domestic product) by 2020 even though revenues were only 14.9 percent of GDP in 2010. Much of this increase in revenue comes from the expiration of major individual income tax cuts.

On February 18, 2010, President Obama announced by Executive Order the formation of the Bipartisan National Commission on Fiscal Responsibility and Reform. The Commission is charged with finding solutions to fiscal challenges confronting the nation, including reducing the deficit. Already, opponents of higher taxes have urged the still-forming Commission to remove any tax increase from consideration, arguing that such increase would harm economic growth. Others argue that all policy options, including higher revenues from taxes, must be part of the debate. In the House of Representatives, the decision to raise or lower taxes initiates within the Ways and Means Committee.

In announcing the hearing, Chairman Neal stated, **"With the creation of the Bipartisan National Commission on Fiscal Responsibility and Reform, President Obama has expressed his willingness to work with Congress to move towards a balanced federal budget. With next year's deficit expected to exceed $1.3 trillion, it is clear we face significant challenges if we are to meet the President's ambitious goals. As a Member of the committee with jurisdiction over tax revenues and many federal spending programs, I look forward exploring all policy options for reducing the federal budget deficits."**

DETAILS FOR SUBMISSION OF WRITTEN COMMENTS:

Please Note: Any person(s) and/or organization(s) wishing to submit for the hearing record must follow the appropriate link on the hearing page of the Committee website and complete the informational forms. From the Committee homepage, ***http://democrats.waysandmeans.house.gov***, select "Hearings". Select the hearing for which you would like to submit, and click on the link entitled, "Click here to provide a submission for the record." Once you have followed the online instructions, submit all requested information. ATTACH your submission as a Word or WordPerfect document, in compliance with the formatting requirements listed below, **by close of business Tuesday, April 6, 2010**. Finally, please note that due to the change in House mail policy, the U.S. Capitol Police will refuse sealed-package deliveries to all House Office Buildings. For questions, or if you encounter technical problems, please call (202) 225–1721 or (202) 225–3625.

FORMATTING REQUIREMENTS:

The Committee relies on electronic submissions for printing the official hearing record. As always, submissions will be included in the record according to the discretion of the Committee. The Committee will not alter the content of your submission, but we reserve the right to format it according to our guidelines. Any submission provided to the Committee by a witness, any supplementary materials submitted for the printed record, and any written comments in response to a request for written comments must conform to the guidelines listed below. Any submission or supplementary item not in compliance with these guidelines will not be printed, but will be maintained in the Committee files for review and use by the Committee.

1. All submissions and supplementary materials must be provided in Word or WordPerfect format and MUST NOT exceed a total of 10 pages, including attachments. Witnesses and submitters are advised that the Committee relies on electronic submissions for printing the official hearing record.

2. Copies of whole documents submitted as exhibit material will not be accepted for printing. Instead, exhibit material should be referenced and quoted or paraphrased. All exhibit material not meeting these specifications will be maintained in the Committee files for review and use by the Committee.

3. All submissions must include a list of all clients, persons, and/or organizations on whose behalf the witness appears. A supplemental sheet must accompany each submission listing the name, company, address, telephone and fax numbers of each witness.

Note: All Committee advisories and news releases are available on the World Wide Web at ***http://democrats.waysandmeans.house.gov***.

The Committee seeks to make its facilities accessible to persons with disabilities. If you are in need of special accommodations, please call 202–225–1721 or 202–226–3411 TTD/TTY in advance of the event (four business days notice is requested). Questions with regard to special accommodation needs in general (including availability of Committee materials in alternative formats) may be directed to the Committee as noted above.

Chairman NEAL. Let me call this hearing to order. And I hope that all could take their seats.

I want to welcome everyone to this hearing of the Select Revenues Measures Subcommittee on Taxes as Part of the Federal Budget.

In yesterday's Washington Post, there was an interesting story with a headline you might have thought was satire. It read, "IMF Tells Wealthy Nations to Watch Debt". I wonder why the IMF has to do that.

But as you read the article, it becomes clear that what the U.S. is grappling with, so many others are too. The IMF official warned that the average debt-to-GDP ratio in the wealthiest countries is projected to reach levels that prevailed after World War II, and that this debt will drag down the potential for the wealthiest nations to continue our economic recovery.

And so while we are in good company, it's not much comfort. We have a responsibility to frankly be responsible, as the world's largest economy. And while we have a budget Committee here in the House, tasked with setting out budget targets each year, this Committee has jurisdiction over a wide swath of spending and entitlement programs, and certainly over all tax revenues.

Today our witnesses will talk about both historical and projected data on spending and taxes. We will also hear from Joint Tax that the deficit picture is not pretty, even before the extension of some awfully popular tax cuts.

In order to be responsible, this Committee is going to have to make some very difficult decisions. It was the Economist, John Maynard Keynes, who said, "If I owe you a pound, and I have a problem, I have a problem. But if I owe you a million, the problem is yours."

This problem is ours and ours alone. I hope this hearing will be the first of many, setting out how we can reform our Tax Code in anticipation of moving our economy forward.

Now let me recognize my friend, Mr. Tiberi, for his opening statement.

Mr. TIBERI. Thank you, Mr. Chairman. It is great to be here with you again, the first hearing of this year for this Subcommittee. I hope we have several more.

During his 1986 state of the union address, President Ronald Reagan said, "Government's view of the economy could be summed up in a few short phrases: If it moves, tax it; if it keeps moving, regulate it; and if it stops moving, subsidize it."

I think those words echo in the minds of the country's job creators as we sit here today, businesses' large domestic employers, American businesses trying to compete around the globe, individual entrepreneurs, and small business owners, the driving force of our economy, find themselves under incredible pressure.

A good portion of it is uncertainty, as a result of the global recession we find ourselves working to claw ourselves out of.

But I can tell you, Mr. Chairman, that another source of that pressure is what they see coming out of Washington, D.C., in the form of more taxes, more spending, more entitlements, and more regulation.

If you'll indulge me for a moment, let me tell you exactly what I mean. A week ago today, I left my central Ohio district, but before I left, I sat down with a group of business owners. One of them told me a story. Ten years ago, he borrowed all the money he could: Friends, relatives, mortgaged his house to the hilt, and started a business, his dream, his garage. He's 55 years old today, and that business employs 300 people. He pays taxes, a lot of them.

He told me that ten years later, faced with the same choice today, he wouldn't make that decision. He wouldn't make that decision to start that business, because of what he sees as policies com-

ing out of Washington, D.C. that cause the risk to be greater than the reward, through our taxes, through our regulatory environment, and through mandates.

I know there are vast differences of opinion between your side of the aisle and mine with respect to topics of taxes and spending.

But the simple facts are, we can't tax ourselves out of a situation. To try to do so won't make our businesses more competitive here at home, won't help American companies with world-wide operations compete against their foreign counterparts, and won't encourage would-be entrepreneurs and innovators to take that risk.

Historical data makes it clear, we don't have a revenue problem, we have a spending problem. In fact, over the past 40 years, total revenues have averaged approximately 18.2 percent of GDP, while outlays have averaged 20.7 percent.

There's a huge concern about record budget deficits in both long and short-term. And I think we all agree on that.

As you noted, when announcing today's hearing, the decision to raise or lower taxes initiates within this Committee. You also noted the Committee has jurisdiction over many federal programs. And while it may not be the focus of today's hearing, I certainly hope that in the future, we look at ways to slow the government's growth of federal entitlement spending. And that will factor in to part of this debate at some point.

Thank you, Mr. Chairman, for your leadership. And I look forward to hearing the witnesses' testimony today.

[The prepared statement of Mr. Tiberi follows:]

OPENING STATEMENT RANKING MEMBER PATRICK J. TIBERI (R-OH)
SUBCOMMITTEE SELECT REVENUE MEASURES
HEARING ON TAXES AND THE FEDERAL BUDGET
MARCH 23, 2010

(REMARKS AS PREPARED)

Thank you, Mr. Chairman. It's nice to be back here with you for the first hearing of the Subcommittee this year.

During his 1986 State of the Union Address, President Ronald Reagan said, "[G]overnment's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

I think those words echo in the minds of this country's job creators as we sit here today. Businesses - large domestic employers, American businesses trying to compete around the globe, individual entrepreneurs, and small business owners, the driving force of our economy – find themselves under incredible pressure. A good portion of it is certainly a result of the global recession we find ourselves working to claw our way out of.

But I can tell you, Mr. Chairman, that another source of that pressure is what they see coming out of Washington, D.C. in the form of more taxes, more spending, more entitlements, and more regulation.

If you'll indulge me for a moment, let me tell you exactly what I mean. A few weeks ago I met with a business owner in my district. Ten years ago he borrowed all the money he could from friends and relatives, mortgaged his house to the hilt, and started a business in his garage. Today, that business employs 300 people; and yes, he pays taxes.

He told me that now – just ten years later, faced with the same choice – he would never take the same chance he did at success. Based on the policies he sees this congress considering today, the risk is far greater than the reward.

I know there are vast differences of opinion between your side of the aisle and mine on the topic of taxes and spending. But the simple fact is that we can't tax ourselves out of this situation; to try to do so won't make our small businesses more competitive here at home, won't help American companies with worldwide operations compete against their foreign counterparts, and won't encourage would-be entrepreneurs and innovators to take the leap.

-OVER-

Historical data makes it clear; we don't have a revenue problem, we have a spending problem. In fact, over the past 40 years, total revenues have averaged approximately 18.2 percent of gross domestic product while outlays have averaged 20.7 percent.

There is huge concern about record budget deficits in both the short and long-term – I think we all agree on that.

As you noted when announcing today's hearing the decision to raise or lower taxes initiates within the Ways and Means Committee. You also noted the committee has jurisdiction over many federal spending programs. While it may not prove to be the focus of today's hearing, I certainly hope that ways to slow the growth of federal entitlement spending will factor into future discussions.

Thank you again, Mr. Chairman for holding this hearing today and thank you to our witnesses. We look forward to your testimony.

###

Chairman NEAL. Thank you, Mr. Tiberi.

Let me welcome our witnesses today. First we'll hear from Tom Barthold, the Chief of Staff at the Joint Committee on Taxation.

Next, we will hear from Len Burman, the Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School at Syracuse University.

Then we will hear from Bob Greenstein—who has arrived—the Executive Director of the Committee on Budget and Policy Priorities here in Washington.

Finally, we will hear from Douglas Holtz-Eakin, the President of the American Action Forum, in Arlington, Virginia.

This is an extremely knowledgeable panel that we've assembled today, and we are fortunate to have their insights on this important topic. Without objection, any other members wishing to insert statements as part of the record may do so. And all written statements submitted by the witnesses will be inserted into the record, as well.

And with that, I would like to recognize Mr. Barthold for his opening statement. And if we could get Mr. Barthold, and perhaps we could have Mr. Burman. And then we will go to vote, and come back.

Mr. Barthold.

STATEMENT OF THOMAS A. BARTHOLD, CHIEF OF STAFF, JOINT COMMITTEE ON TAXATION

Mr. BARTHOLD. Thank you, Mr. Chairman, Mr. Tiberi. My name is Thomas Barthold, and I'm the Chief of Staff of the Joint Committee on Taxation. And it's a pleasure to present some background information on projections of the U.S. tax system, and the outlook for deficits, and also to highlight some looming issues in the individual income tax.

I prepared a deck of slides, which are mounted up here. And I don't pretend to have the time to go through all of them. The staff also prepared a more detailed background pamphlet that was made available to you and the general public.

Just to state where we've been historically, the first slide just gives you a picture of federal receipts as a percentage of gross domestic product since 1934. I think the point that was partly made by Mr. Tiberi is that essentially since 1950, receipts as a percentage of GDP have bounced around between 16–1/2 and 19–1/2 percent.

But that picture of receipts sort of masked an overall difference in terms of the evolution of the U.S. Federal Revenue System. And the next slide breaks that down into our major components, which is the individual income tax, our employment taxes, the payroll taxes, corporate income taxes, and then the lesser revenue sources of excise taxes and estate and gift taxes.

As you can see, the major change over this period is that while the individual income tax remains our largest source of federal revenues, over 40 percent annually, for the past 60 years, the role of employment taxes has grown substantially over that period, while the relative importance of corporate income taxes has declined. Of course, these are in percentage terms; not dollar figures.

Just to show you where we are today, I have a simple pie chart. Individual income tax, we project, will account for 43 percent of federal revenues in 2010. The social insurance tax is 40 percent; corporate income tax 9 percent.

A point that I hope to have a couple minutes to highlight later is the looming changes in the individual income tax that face the Committee, because of the expiration of many of the provisions, enacted as part of EGTRRA and JGTRRA. That leads to a changed outlook for 2011. So, the comparison pie chart available to you shows that under baseline projections, without any action by the Congress, individual income tax receipts will rise to 48 percent of federal revenues, Social insurance taxes will commensurately decline.

Mr. Neal had asked to present some information from both our Joint Tax projections and Congressional Budget Office projections relating to the growth of revenues and outlays, and the deficit.

This next slide looks at outlays, revenues, and deficits as a percentage of gross domestic product under baseline projections.

As you'll see, in part, because the expiring provisions in the individual income tax, and because the Congressional Budget Office projects that the economy will recover from our recent recession, revenues will grow, and our quite high short-run deficits will decline. But they will persist at a level of near 3 percent of GDP, to the year 2020.

A number of members have asked: Well, what happens if we were to extend all the EGTRRA and JGTRRA sunsets, and provide AMT relief, as the Congress has been doing annually now for just about the past decade?

This next slide shows the effect of those policies, and essentially it would increase the deficit by about 2 percent per year, throughout the ten-year period. So, while I said that we'd be at roughly 3 percent of GDP in 2020, it would be about 5 percent of GDP in 2020.

I should note that the policies that are projected there, that it's not any particular choice of ours; it was just simple to say, "Let's look at not letting all these provisions expire." And the AMT relief is done by indexing the exemption amount and the thresholds.

The next slide shows the same facts, with a focus on the deficit, as opposed to outlays and revenues.

I'd like to talk for a few minutes about the changes that are coming in the individual income tax, the expiration of a number of the EGTRRA and JGTRRA provisions. The individual income tax is defined by its basic standard deduction, its personal exemptions, the rate brackets, and then a number of other provisions, such as the child credit, the earned income tax credit, and the new making-work-pay credit.

Part of the EGTRRA legislation was to provide marriage penalty relief. That was done by effectively having the standard deduction for taxpayers married filing jointly be double that of singles. The reason this is highlighted in blue on my chart is to note the change between 2010 and 2011, when that relief would change.

The other big basic change, of course, is the change in the rate structure. I know the arrows look a little bit complicated, but what's happening is that for tax payers who would be in the 10

percent bracket in 2010, they would now all return to the 15 percent bracket. Some taxpayers in the 15 percent bracket in 2010, will remain in the 15 percent bracket. Some married filing jointly, who had received some rate relief as part of the doubling of the thresholds in EGTRRA, would go to the 28 percent bracket. The 25 percent bracket returns to 28, et cetera, as detailed.

That's for ordinary income.

There's also the special maximum rate amounts for capital gain and qualified dividend income.

Another perhaps important change to note is the child tax credit has a maximum value currently of $1,000. In 2011, that drops down to $500.

The significant change in earned income tax parameters, is that the Congress had created a category for three or more children. That reverts to just the two or more child category.

I'll skip over a couple of the additional slides, to turn to the Alternative Minimum Tax (AMT). The Alternative Minimum Tax problem that you have dealt with over the past several years, without adjusting exemptions or other policy change, is projected to affect over 25 million taxpayers for 2010. If we were to take the 2009 alternative minimum tax and index it, that number of affected taxpayers would fall to about $4.1 million.

In the interest of time, I'll skip to the last couple slides, which I think encapsulate the effects of the expiration of EGTRRA and JGTRRA by making a hypothetical calculation for a married couple with no children, assuming that all their income is wage income.

The brown line will be their 2011 tax liability. The blue line is their current law tax liability. For a comparable picture, if the couple has two children, the difference is, that they can be eligible for a larger earned income tax credit for lower income tax payers. And, for most of the taxpayers on this income chart, they'd be eligible for the child tax credit.

In conclusion, the staff has tried to provide the members with a lot more detail. And, I'd be happy to explain any of the additional detail that the members might like to enquire about.

Thank you, Mr. Chairman.

[The prepared statement Mr. Barthold follows:]

Testimony By Thomas A. Barthold
Chief of Staff Joint Committee on Taxation

JOINT COMMITTEE ON TAXATION
March 23, 2010
JCX-20-10

Testimony of the Staff of the Joint Committee on Taxation Before the Select Revenue Measures Subcommittee of the House Committee on Ways and Means Hearing on Taxes as Part of the Federal Budget March 23, 2010

My name is Thomas A. Barthold. I am Chief of Staff of the Joint Committee on Taxation. It is my pleasure to present the testimony of the staff of the Joint Committee on Taxation today providing Committee members with background information on taxes as part of the Federal budget.

Overview

The Joint Committee staff has prepared a pamphlet briefly summarizing present law for the major components of the U.S. tax system: the individual income tax; the social insurance taxes; the corporate income tax; the estate, gift, and generation skipping taxes; and Federal excise taxes.[1] That pamphlet also provides background data on the history of Federal revenue sources and provides projections of future receipts. The pamphlet also highlights certain significant features of the individual income tax that are scheduled to expire at the end of calendar year 2010.

My testimony today highlights in slides some of the material presented in more detail in the JCX-19-10. In particular the following observations may be of value to Committee members as they discuss the role of Federal taxes as part of the Federal budget.

---

[1] See Joint Committee on Taxation, *Present Law and Background Data Related to the Federal Tax System in Effect for 2010 and 2011* (JCX-19-10), March 22, 2010, available on the Joint Committee on Taxation website at www.jct.gov

- For the past 60 years Federal tax receipts generally have comprised 17 to 19 percent of U.S. gross domestic product. The recent recession has reduced receipts to 15 percent of GDP. Under the CBO baseline, receipts will rise to 20.3 percent of GDP in 2020.
- For 2010, our staff projects that individual income tax receipts will provide 43 percent of Federal revenues and the payroll taxes will provide 40 percent of Federal revenues.
- The individual income tax has long been the largest source of Federal revenues. For the past 60 years the payroll taxes have grown as a revenue source and the percentage of corporate income tax revenues has declined.
- Deficit projections: Under the CBO baseline, deficits are projected to be 9.3 percent of GDP in 2010, falling to three percent of GDP in 2020. JCT projects the deficit would be five percent of GDP with extensions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA") and Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA"), indexation of the alternative minimum tax ("AMT"), and maintaining the 2009 estate and gift tax parameters.
- Significant individual income tax provisions scheduled to change as a result of EGTRRA, JGTRRA, and the American Recovery and Reinvestment Tax Act of 2009 ("ARRTA") :

  EGTRRA/JGTRRA:
  - Standard deduction for married couples is reduced
  - Marriage penalty rate relief expires
  - Regular Individual tax rates increase
  - Capital gain and dividend rates increase
  - Child tax credit falls and refundability is reduced
  - Married couple earned income tax credit is reduced
  - Personal exemption and itemized deduction phaseouts return

  ARRTA:
  - Making work pay credit expires
  - American Opportunity credit is reduced; is no longer refundable
  - Special earned income tax credit rules for 3 or more children expire

- The AMT will affect over 25 million taxpayers in 2010, as compared to about 4 million in 2009, if the AMT exemption levels are not increased. Over 37 million taxpayers will be affected in 2020.

PRESENT LAW AND BACKGROUND DATA RELATED TO THE FEDERAL TAX SYSTEM IN EFFECT FOR 2010 AND 2011

Scheduled for a Public Hearing
Before the
SUBCOMMITTEE ON SELECT REVENUE MEASURES
of the
HOUSE COMMITTEE ON WAYS AND MEANS
on March 23, 2010

Prepared by the Staff
of the
JOINT COMMITTEE ON TAXATION

March 22, 2010
JCX-19-10

CONTENTS

Page

INTRODUCTION 1

I. SUMMARY OF THE INDIVIDUAL INCOME TAX 2

A. Individual Income Tax for 2010 2

B. Individual Income Tax for 2011 9

II. SUMMARY OF SOCIAL INSURANCE TAXES 14

A. Taxable Year 2010 14

B. Taxable Year 2011 14

III. SUMMARY OF THE CORPORATE INCOME TAX 15

A. Corporate Income Tax for 2010 15

B. Corporate Income Tax for 2011 19

IV. SUMMARY OF ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES 20

V. SUMMARY OF MAJOR EXCISE TAXES FOR 2010 AND 2011 23

VI. BACKGROUND DATA 24

A. Historical Federal Receipts by Source 24

B. Present and Future Federal Receipts 28

C. Selected Data Related to the Individual Income Tax in 2010 and 2011 36

INTRODUCTION

The Subcommittee on Select Revenue Measures of the House Committee on Ways and Means has scheduled a public hearing on March 23, 2010, on taxes and the Federal budget. This document,[1] prepared by the staff of the Joint Committee on Taxation, provides a summary of the present-law Federal tax system in effect for 2010 and 2011. The changes in 2011 primarily reflect sunset provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA")[2] and the Jobs and Growth Tax Relief Reconciliation Act of 2003 ("JGTRRA")[3] as well as the expiration of provisions contained in the American Recovery and Reinvestment Tax Act of 2009 ("ARRTA")[4].

The current Federal tax system has four main elements: (1) an income tax on individuals and corporations (which consist of both a "regular" income tax and an alternative minimum tax); (2) payroll taxes on wages (and corresponding taxes on self-employment income); (3) estate, gift, and generation-skipping transfer taxes; and (4) excise taxes on selected goods and services.

In addition to the expiration of temporary provisions of Federal tax law, a number of aspects of the Federal tax laws are subject to change over time. For example, some dollar amounts and income thresholds are indexed for inflation. The standard deduction and the individual income tax rate brackets are examples of amounts that are indexed for inflation. The amount of earnings subject to the Social Security tax is adjusted annually for wage growth. In general, the Internal Revenue Service adjusts these numbers annually and publishes the inflation-adjusted amounts in effect for a tax year prior to the beginning of that year. Where applicable, this document generally includes dollar amounts in effect for 2010 (or 2011) and notes whether dollar amounts are indexed for inflation.

---

[1] This document may be cited as follows: Joint Committee on Taxation, *Present Law and Background Data Related to the Federal Tax System in Effect for 2010 and 2011* (JCX-19-10), March 22, 2010. This document can be found on the Joint Committee on Taxation website at www.jct.gov.

[2] Pub. L. No. 107-16.

[3] Pub. L. No. 108-27.

[4] Division B, Title I, of the "American Recovery and Reinvestment Act of 2009," Pub. L. No. 111-5.

I. SUMMARY OF THE INDIVIDUAL INCOME TAX

A. Individual Income Tax for 2010

In general

An income tax is imposed on individual citizens and residents of the United States.[5] The tax is based on an individual's taxable income. An individual computes his or her taxable income by reducing gross income by the sum of (i) the deductions allowable in computing adjusted gross income, (ii) the standard deduction (or itemized deductions, at the election of the taxpayer), and (iii) the deduction for personal exemptions. Graduated tax rates are then applied to a taxpayer's taxable income to determine his or her income tax liability. Lower rates apply to net capital gain and qualified dividend income. A taxpayer may also be subject to an alternative minimum tax. A taxpayer may reduce his or her income tax liability by certain tax credits.

Gross income

Gross income means "income from whatever source derived" other than certain items specifically excluded from gross income. Sources of gross income generally include, among other things, compensation for services, interest, dividends, capital gains, rents, royalties, alimony and separate maintenance payments, annuities, income from life insurance and endowment contracts (other than certain death benefits), pensions, gross profits from a trade or business, income in respect of a decedent, and income from S corporations, partnerships,[6] and trusts or estates.[7] Exclusions from gross income include death benefits payable under a life insurance contract, interest on certain tax-exempt State and local bonds, employer-provided health insurance, employer-provided pension contributions, and certain other employer-provided benefits.

Adjusted gross income

An individual's adjusted gross income ("AGI") is determined by subtracting certain allowable deductions from gross income. These deductions are known as "above-the-line" deductions. These deductions are generally the expenses incurred to produce gross income. For example, these deductions include trade or business deductions (other than certain deductions for

---

[5] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A nonresident alien generally is subject to the U.S. individual income tax only on income with a sufficient nexus to the United States.

[6] In general, partnerships and S corporations are treated as pass-through entities for Federal income tax purposes. Thus, no Federal income tax is imposed at the entity level. Rather, income of these entities is passed through and taxed to the partners or shareholders.

[7] In general, estates and trusts (other than grantor trusts) pay an individual income tax on the taxable income of the estate or trust. Items of income which are distributed or required to be distributed under governing law or under the terms of the governing instrument generally are included in the income of the beneficiary and not the estate or trust. These entities determine their tax liability using a special tax rate schedule and may be subject to the alternative minimum tax. Certain trusts are treated as being owned by grantors in whole or in part for tax purposes; in such cases, the grantors are taxed on the income of the trust.

services performed as an employee), losses from the sale or exchange of property, deductions attributable to rents and royalties, contributions to pensions and other retirement plans, alimony payments, and moving expenses.

Taxable income

In order to determine taxable income, a taxpayer reduces AGI by any personal exemption deductions and either the applicable standard deduction or the taxpayer's itemized deductions. Personal exemptions generally are allowed for the taxpayer, his or her spouse, and any dependents. For 2010, the amount deductible for each personal exemption is $3,650. This amount is indexed annually for inflation. For 2010, the deduction for personal exemptions is not reduced or eliminated for taxpayers with incomes over certain thresholds. A taxpayer also may reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2010, the amount of the standard deduction is $5,700 for single individuals and married individuals filing separate returns, $8,400 for heads of households, and $11,400 for married individuals filing a joint return and surviving spouses. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[8] The amounts of the basic standard deduction and the additional standard deduction are indexed annually for inflation.

Table 1.–Personal Exemption and Basic Standard Deduction for 2010

Personal Exemption	$3,650
Basic Standard Deduction:	
Single and married filing separately	$5,700
Head of household	$8,400
Married filing jointly	$11,400

In lieu of taking the applicable standard deductions, an individual may elect to itemize deductions. The deductions that may be itemized include State and local income taxes, real property and certain personal property taxes, home mortgage interest, charitable contributions, certain investment interest, medical expenses (in excess of 7.5 percent of AGI), casualty and theft losses (in excess of $100 per loss and in excess of 10 percent of AGI), and certain miscellaneous expenses (in excess of two percent of AGI). For 2010, the total amount of itemized deductions allowed is not reduced for taxpayers with incomes over a certain threshold amount.

[8] For 2010, the additional amount is $1,100 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,400. If an individual is both blind and aged, the individual is entitled to two additional standard deductions, for a total additional amount (for 2010) of $2,200 or $2,800, as applicable.

Tax liability

In general

A taxpayer's net income tax liability is the greater of (1) regular individual income tax liability reduced by credits allowed against the regular tax, or (2) tentative minimum tax reduced by credits allowed against the minimum tax. The amount of income subject to tax is determined differently under the regular tax and the alternative minimum tax, and separate rate schedules apply. Lower rates apply for long-term capital gains and qualified dividend income; those rates apply for both the regular tax and the alternative minimum tax.

Regular tax liability

To determine regular tax liability, a taxpayer generally must apply the tax rate schedules (or the tax tables) to the taxpayer's regular taxable income. The rate schedules are broken into several ranges of income, known as income brackets, and the marginal tax rate increases as a taxpayer's income increases. Separate rate schedules apply based on an individual's filing status. For 2010, the regular individual income tax rate schedules are as follows:

Table 2.–Federal Individual Income Tax Rates for 2010

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $8,375	10% of the taxable income
Over $8,375 but not over $34,000	$837.50 plus 15% of the excess over $8,375
Over $34,000 but not over $82,400	$4,681.25 plus 25% of the excess over $34,000
Over $82,400 but not over $171,850	$16,781.25 plus 28% of the excess over $82,400
Over $171,850 but not over $373,650	$41,827.25 plus 33% of the excess over $171,850
Over $373,650	$108,421.25 plus 35% of the excess over $373,650

Heads of Households

Not over $11,950	10% of the taxable income
Over $11,950 but not over $45,550	$1,195 plus 15% of the excess over $11,950
Over $45,550 but not over $117,650	$6,235 plus 25% of the excess over $45,550
Over $117,650 but not over $190,550	$24,260 plus 28% of the excess over $117,650
Over $190,550 but not over $373,650	$44,672 plus 33% of the excess over $190,550
Over $373,650	$105,095 plus 35% of the excess over $373,650

Married Individuals Filing Joint Returns and Surviving Spouses

Not over $16,750	10% of the taxable income
Over $16,750 but not over $68,000	$1,675 plus 15% of the excess over $16,750
Over $68,000 but not over $137,300	$9,362.50 plus 25% of the excess over $68,000
Over $137,300 but not over $209,250	$26,687.50 plus 28% of the excess over $137,300
Over $209,250 but not over $373,650	$46,833.50 plus 33% of the excess over $209,250
Over $373,650	$101,085.50 plus 35% of the excess over $373,650

Married Individuals Filing Separate Returns

Not over $8,375	10% of the taxable income
Over $8,375 but not over $34,000	$837.50 plus 15% of the excess over $8,375
Over $34,000 but not over $68,650	$4,681.50 plus 25% of the excess over $34,000
Over $68,650 but not over $104,625	$13,343.75 plus 28% of the excess over $68,650
Over $104,625 but not over $186,825	$23,416.75 plus 33% of the excess over $104,625
Over $186,825	$50,542.75 plus 35% of the excess over $186,825

Alternative minimum tax liability

An alternative minimum tax is imposed on an individual, estate, or trust in an amount by which the tentative minimum tax exceeds the regular income tax for the taxable year. The tentative minimum tax is the sum of (1) 26 percent of so much of the taxable excess as does not

exceed $175,000 ($87,500 in the case of a married individual filing a separate return) and (2) 28 percent of the remaining taxable excess. The taxable excess is so much of the alternative minimum taxable income ("AMTI") as exceeds the exemption amount. The maximum tax rates on net capital gain and dividends used in computing the regular tax are also used in computing the tentative minimum tax. AMTI is the taxpayer's taxable income increased by the taxpayer's "tax preference items" and adjusted by redetermining the tax treatment of certain items in a manner that negates the deferral of income resulting from the regular tax treatment of those items.

The exemption amounts for 2010 are: (1) $45,000 in the case of married individuals filing a joint return and surviving spouses; (2) $33,750 in the case of unmarried individuals other than surviving spouses; (3) $22,500 in the case of married individuals filing separate returns; and (4) $22,500 in the case of an estate or trust.[9] The exemption amounts are phased out by an amount equal to 25 percent of the amount by which the individual's AMTI exceeds: (1) $150,000 in the case of married individuals filing a joint return and surviving spouses; (2) $112,500 in the case of other unmarried individuals; and (3) $75,000 in the case of married individuals filing separate returns or an estate or a trust. These amounts are not indexed for inflation.

Among the preferences and adjustments applicable to the individual alternative minimum tax are accelerated depreciation on certain property used in a trade or business, circulation expenditures, research and experimental expenditures, certain expenses and allowances related to oil and gas and mining exploration and development, certain tax-exempt interest income, and a portion of the amount of gain excluded with respect to the sale or disposition of certain small business stock. In addition, personal exemptions, the standard deduction, and certain itemized deductions, such as State and local taxes and miscellaneous deductions items, are not allowed to reduce alternative minimum taxable income.

Special capital gains and dividends rates

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 a capital asset, any gain generally is included in income. Any net capital gain of an individual is taxed at maximum rates lower than the rates applicable to ordinary income. 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 for more than one year.

Capital losses generally are deductible in full against capital gains. In addition, individual taxpayers may deduct up to $3,000 of capital losses from ordinary income in each year. Any remaining unused capital losses may be carried forward indefinitely to another taxable year.

---

[9] The exemption amounts for 2009 were: (1) $70,950 in the case of married individuals filing a joint return and surviving spouses; (2) $46,700 in the case of unmarried individuals other than surviving spouses; (3) $35,475 in the case of married individuals filing separate returns; and (4) $35,475 in the case of an estate or trust.

Maximum tax rates apply to capital gains and certain qualified dividends. For 2010, the maximum rate of tax on the adjusted net capital gain of an individual is 15 percent. In addition, any adjusted net capital gain otherwise taxed at a 10- or 15-percent rate is taxed at a zero-percent rate. These rates apply for purposes of both the regular tax and the alternative minimum tax.

These rates also apply to qualified dividend income.

Credits against tax

The individual may reduce his or her tax liability by any available tax credits. For example, tax credits are allowed for certain business expenditures, certain foreign income taxes paid or accrued, certain elderly or disabled individuals, certain child care expenditures, certain adoption expenses, the earned income tax credit ("EITC") for low-income workers who satisfy certain requirements, the child tax credit, and the credit for certain health care expenses. Additional tax credits include: the making work pay tax credit, the American opportunity tax credit, and a tax credit for certain first-time homebuyers. Tax credits allowed against the regular tax are not uniformly allowed against the alternative minimum tax.

A brief description of the most widely used credits follows.

Earned income tax credit.–The amount of the EITC varies depending upon the taxpayer's earned income and whether the taxpayer has one, two, more than two, or no qualifying children. In 2010, the maximum EITC is $5,666 for taxpayers with more than two qualifying children, $5,036 for taxpayers with two qualifying children, $3,050 for taxpayers with one qualifying child, and $457 for taxpayers with no qualifying children. The EITC is phased out along certain phase-out ranges. For 2010, the phase-out range is $7,480 to $13,460 for no qualifying children, $16,450 to $35,535 for one qualifying child, $16,450 to $40,363 for two qualifying children, and $16,450 to $43,352 for three or more qualifying children. For 2010, the phase-out thresholds for married couples filing a joint return is increased by $5,010.

Child tax credit.–For 2010, the child tax credit generally is $1,000 but is phased-out for individuals with income over certain thresholds. For 2010, the child tax credit is refundable up to the greater of (1) 15 percent of the taxpayer's earned income in excess of $3,000; or (2) for families with three or more children, the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income.

Health coverage tax credit.–The health coverage tax credit is a refundable tax credit for a taxpayer who is an eligible individual. For 2010, the credit is equal to 80 percent of the premiums paid by the taxpayer for months of eligible coverage under qualified health insurance of the taxpayer and qualifying family members. The credit is available on an advance basis through a program established and administered by the Treasury Department. In general, eligible individuals are individuals who receive a trade adjustment allowance (and individuals who would be eligible to receive such an allowance but for the fact that they have not exhausted their regular unemployment benefits), individuals eligible for the alternative trade adjustment assistance program, and individuals over age 55 who receive pension benefits from the Pension Benefit Guaranty Corporation. For 2010, family members of Medicare eligible individuals are eligible for the credit for 24 months after certain events that otherwise terminate eligibility for

the credit, including the taxpayer's entitlement to Medicare Part A or enrollment in Medicare Part B, the death of the taxpayer who was the eligible individual, or divorce between the eligible individual and the individual's spouse.

Making work pay tax credit.–The making work pay tax credit for 2010 is equal to the lesser of (1) 6.2 percent of the individual's earned income, or (2) $400 ($800 in the case of a joint return). The credit is phased out at a rate of two percent of the eligible individual's modified adjusted gross income above $75,000 ($150,000 in the case of a joint return).

American opportunity tax credit.–For 2010, the credit is equal to up to $2,500 per eligible student per year for qualified tuition and related expenses paid for each of the first four years of the student's post-secondary education in a degree or certificate program. Also, the credit is phased out ratably for taxpayers with adjusted gross income between $80,000 and $90,000 ($160,000 and $190,000 for married taxpayers filing a joint return). 40 percent of the otherwise allowable credit is refundable for 2010.

First-time homebuyer tax credit.–A refundable first-time homebuyer tax credit is allowed equal to the lesser of $8,000 ($4,000 for a married individual filing a separate return) or 10 percent of the purchase price of a principal residence. Certain long-term residents of the same principal residence are treated as eligible for the first-time homebuyer credit. In the case of the long-time resident of the same principal residence, the maximum refundable credit allowed is equal to the lesser of $6,500 ($3,250 for a married individual filing a separate return) or 10 percent of the purchase price of a principal residence. The credit is allowable only for certain purchases before May 1, 2010 (before July 1, 2010 with respect to written binding contracts before May 1, 2010).

B. Individual Income Tax for 2011[10]

Adjusted gross income

There are no significant changes to the calculation of gross income and adjusted gross income between 2010 and 2011.

Taxable income

Taxable income will rise in 2011 for most taxpayers due to lower basic standard deduction amounts and the re-imposition of limits on personal exemptions and many itemized deductions.

For 2011, the amount deductible for each personal exemption is $3,750. This amount is indexed annually for inflation. For 2011, the deduction for personal exemptions is reduced or eliminated for taxpayers with incomes over certain thresholds, which are indexed annually for inflation.[11] The applicable thresholds for 2011 are $171,000 for single individuals, $256,700 for married individuals filing a joint return and surviving spouses, $213,900 for heads of households, and $128,350 for married individuals filing separate returns. A taxpayer also may reduce AGI by the amount of the applicable standard deduction. The basic standard deduction varies depending upon a taxpayer's filing status. For 2011, the amount of the standard deduction is $5,800 for single individuals, $8,600 for heads of households, and $9,750 for married individuals filing a joint return and surviving spouses, and $4,875 for married filing separate returns. An additional standard deduction is allowed with respect to any individual who is elderly or blind.[12] The amounts of the basic standard deduction and the additional standard deductions are indexed annually for inflation.

[10] The dollar amounts for 2011 in this section, which represent inflation adjustments, are the estimates by the staff of the Joint Committee on Taxation based on Congressional Budget Office baseline inflation estimates.

[11] This is commonly called the personal exemption phase-out ("PEP").

[12] For 2011, the additional amount is $1,150 for married taxpayers (for each spouse meeting the applicable criterion) and surviving spouses. The additional amount for single individuals and heads of households is $1,450. If an individual is both blind and aged, the individual is entitled to two additional standard deductions, for a total additional amount (for 2011) of $2,300 or $2,900, as applicable.

Table 3.–Personal Exemption and Basic Standard Deduction for 2011

Personal Exemption	$3,750
Basic Standard Deduction:	
Married filing separately	$4,875
Single	$5,800
Head of household	$8,600
Married filing jointly	$9,750

In lieu of taking the applicable standard deductions, an individual may elect to itemize deductions. For 2011, the total amount of most itemized deductions allowed is reduced for taxpayers with incomes over a certain threshold amount, which is indexed annually for inflation.[13] Certain itemized deductions are not reduced (i.e., medical expenses, investment income, theft and casualty losses and gambling losses). The threshold amount for 2011 is $171,000 ($85,550 for married individuals filing separate returns).

Tax liability

Regular tax liability

In general, the calculation of regular tax liability between 2010 and 2011 remains unchanged except for the significant exception of the individual income tax rates as set forth below.

Table 4.–Federal Individual Income Tax Rates for 2011

If taxable income is:	Then income tax equals:
Single Individuals	
Not over $34,850	15% of the taxable income
Over $34,850 but not over $84,350	$5,227.50 plus 28% of the excess over $34,850
Over $84,350 but not over $176,000	$19,087.50 plus 31% of the excess over $84,350
Over $176,000 but not over $382,650	$47,499 plus 36% of the excess over $176,000
Over $382,650	$121,893 plus 39.6% of the excess over $382,650

[13] This limitation is commonly called the "Pease" limitation.

Heads of Households

Not over $46,650	15% of the taxable income
Over $46,650 but not over $120,500	$6,997.50 plus 28% of the excess over $46,650
Over $120,500 but not over $195,150	$27,675.50 plus 31% of the excess over $120,500
Over $195,150 but not over $382,650	$50,817 plus 36% of the excess over $195,150
Over $382,650	$118,317 plus 39.6% of the excess over $382,650

Married Individuals Filing Joint Returns and Surviving Spouses

Not over $58,200	15% of the taxable income
Over $58,200 but not over $140,600	$8,730 plus 28% of the excess over $58,200
Over $140,600 but not over $214,250	$31,802 plus 31% of the excess over $140,600
Over $214,250 but not over $382,650	$54,633.50 plus 36% of the excess over $214,250
Over $382,650	$115,257.50 plus 39.6% of the excess over $382,650

Married Individuals Filing Separate Returns

Not over $29,100	15% of the taxable income
Over $29,100 but not over $70,300	$4,365 plus 28% of the excess over $29,100
Over $70,300 but not over $107,125	$15,901 plus 31% of the excess over $70,300
Over $107,125 but not over $191,325	$27,316.75 plus 36% of the excess over $107,125
Over $191,325	$57,628.75 plus 39.6% of the excess over $191,325

Alternative minimum tax liability

The rates and exemption amounts for 2010 remain unchanged for 2011.

Special capital gains and dividends rates

Maximum tax rates apply to capital gains. For 2011, the maximum rate of tax on the adjusted net capital gain of an individual is 20 percent (18 percent for property purchased after 2000 and held more than five years). In addition, any adjusted net capital gain otherwise taxed at

a 15-percent rate is taxed at a 10-percent rate (8 percent for property held more than five years). These rates apply for purposes of both the regular tax and the alternative minimum tax. Qualified dividend income is taxed at regular tax rates. These provisions will result in higher taxes on both capital gains and dividends in 2011.

Credits against tax

The individual may reduce his or her tax liability by any available tax credits. For example, tax credits are allowed for certain business expenditures, certain foreign income taxes paid or accrued, certain elderly or disabled individuals, certain child care expenditures, certain adoption expenses, the earned income tax credit ("EITC") for low-income workers who satisfy certain requirements, the child tax credit, and the credit for certain health care expenses. Additional tax credits include: the making work pay tax credit, the American opportunity tax credit, and a tax credit for certain first-time homebuyers. Tax credits allowed against the regular tax are not uniformly allowed against the alternative minimum tax.

A brief description of the most widely used credits follows. The expiration of part or all of these tax credits will increase tax liability for 2011.

Earned income tax credit.–The amount of the EITC varies depending upon the taxpayer's earned income and whether the taxpayer has one, two or more, or no qualifying children. The various income thresholds that determine the amount of the credit are indexed to inflation. In 2011, the maximum EITC is projected to be $5,100 for taxpayers with two or more qualifying children, $3,089 for taxpayers with one qualifying child, and $463 for taxpayers with no qualifying children. The EITC is phased out along certain phase-out ranges. For 2011, the phase out range is projected to be $7,580 to $13,630 for no qualifying children, $16,660 to $35,990 for one qualifying child, and $16,660 to $40,880 for two or more qualifying children. For 2011, the phase-out thresholds for married couples filing a joint return are the same as for other filers..

Child tax credit.–For 2011, the child tax credit generally is $500 but is phased-out for individuals with income over certain thresholds. For 2011, the child tax credit is refundable for families with three or more children, to the extent by which the amount by which the taxpayer's social security taxes exceed the taxpayer's earned income.

Health coverage tax credit.–For months after December 31, 2010, the health coverage tax credit is reduced from 80 percent to 65 percent of the cost of qualified health insurance paid by an eligible individual. Certain other provisions with respect to the credit cease to apply for months after December 31, 2010, including, for example, the provision allowing family members to be eligible for the credit for 24 months after certain events that otherwise terminate eligibility for the credit.[14]

Making work pay tax credit.–The making work pay tax credit is not available for 2011.

[14] Secs. 1899 to 1899H of the American Recovery and Reinvestment Act (Pub. L. No. 111-5) made certain changes to the provisions for the health coverage tax credit which only apply to months before January 1, 2011.

American opportunity tax credit.–The American opportunity tax credit expires after 2010 and the HOPE credit resumes its place after the American opportunity tax credit's expiration. For 2011, the HOPE credit can be up to $1,800 per eligible student per year for qualified tuition and related expenses paid for each of the first two years of the student's post-secondary education in a degree or certificate program. For 2011, the credit is phased out ratably for taxpayers with adjusted gross income between $51,000 and $61,000 ($102,000 and $122,000 for married taxpayers filing a joint return). The otherwise allowable credit is not refundable for 2011.

First-time homebuyer credit.–The first-time homebuyer tax credit is not available for 2011.

II. SUMMARY OF SOCIAL INSURANCE TAXES

A. Taxable Year 2010

Social security benefits and certain Medicare benefits are financed primarily by payroll taxes on covered wages. The Federal Insurance Contributions Act ("FICA") imposes tax on employers[15] based on the amount of wages paid to an employee during the year. The tax imposed is composed of two parts: (1) the old age, survivors, and disability insurance ("OASDI") tax equal to 6.2 percent of covered wages up to the taxable wage base ($106,800 in 2010); and (2) the Medicare hospital insurance ("HI") tax amount equal to 1.45 percent of covered wages. In addition to the tax on employers, each employee is subject to FICA taxes equal to the amount of tax imposed on the employer. The employee-level tax generally must be withheld and remitted to the Federal government by the employer.

As a parallel to FICA taxes, the Self-Employment Contributions Act ("SECA") imposes taxes on the net income from self employment of self-employed individuals. The rate of the OASDI portion of SECA taxes is equal to the combined employee and employer OASDI FICA tax rates and applies to self employment income up to the FICA taxable wage base. Similarly, the rate of the HI portion is the same as the combined employer and employee HI rates and there is no cap on the amount of self employment income to which the rate applies.[16]

In addition to FICA taxes, employers are subject to a Federal unemployment insurance payroll tax ("FUTA") equal to 6.2 percent of the total wages of each employee (up to $7,000) on covered employment. Employers are eligible for a Federal credit equal to 5.4 percent for State unemployment taxes. For 2010, the current 0.8 percent average tax rate (i.e., 6.2 minus 5.4) is composed of a permanent tax rate of 0.6 percent and a temporary surtax rate of 0.2 percent. Federal unemployment insurance payroll taxes are used to fund programs maintained by the States for the benefit of unemployed workers.

B. Taxable Year 2011

Social insurance taxes remain generally the same in 2011 as for 2010. The temporary FUTA surtax rate of 0.2 percent expires after the first six months of 2011.[17]

---

[15] Employers who hire certain unemployed or part-time workers this year (after Feb. 3, 2010 and before Jan. 1, 2011) may qualify for an exemption, for the remainder of the year, of their share of Social Security taxes on wages paid to these workers on or after March 19, 2010.

[16] For purposes of computing net earnings from self employment, taxpayers are permitted a deduction equal to the product of the taxpayer's earnings (determined without regard to this deduction) and one-half of the sum of the rates for OASDI (12.4 percent) and HI (2.9 percent), i.e., 7.65 percent of net earnings. This deduction reflects the fact that the FICA rates apply to an employee's wages, which do not include FICA taxes paid by the employer, whereas the self-employed individual's net earnings are economically equivalent to an employee's wages plus the employer share of FICA taxes.

[17] Pub. L. No. 111-92.

III. SUMMARY OF THE CORPORATE INCOME TAX

A. Corporate Income Tax for 2010

In general, corporations organized under the laws of any of the 50 States (and the District of Columbia) are subject to the U.S. corporate income tax on their worldwide taxable income.[18]

Taxable income

The taxable income of a corporation generally is comprised of gross income less allowable deductions. Gross income generally is income derived from any source, including gross profit from the sale of goods and services to customers, rents, royalties, interest (other than interest from certain indebtedness issued by State and local governments), dividends, gains from the sale of business and investment assets, and other income.

Allowable deductions include ordinary and necessary business expenditures, such as salaries, wages, contributions to profit-sharing and pension plans and other employee benefit programs, repairs, bad debts, taxes (other than Federal income taxes), contributions to charitable organizations (subject to an income limitation), advertising, interest expense, certain losses, selling expenses, and other expenses. Expenditures that produce benefits in future taxable years to a taxpayer's business or income-producing activities (such as the purchase of plant and equipment) generally are capitalized and recovered over time through depreciation, amortization or depletion allowances. Generally, a net operating loss incurred in one taxable year may be carried back two years or carried forward 20 years and allowed as a deduction in another taxable year. Under a special carryback provision, certain taxpayers may elect to increase the carryback period for one applicable net operating loss (for a taxable year ending after December 31, 2007 and beginning before January 1, 2010) from two years to any whole number which is more than two and less than six.[19] Deductions are also allowed for certain amounts despite the lack of a direct expenditure by the taxpayer. For example, a deduction is allowed for all or a portion of the amount of dividends received by a corporation from another corporation (provided certain ownership requirements are satisfied). Moreover, a deduction is allowed for a portion of the amount of income attributable to certain domestic production activities.

---

[18] Foreign tax credits generally are available against U.S. income tax imposed on foreign source income to the extent of foreign income taxes paid on that income. A foreign corporation generally is subject to the U.S. corporate income tax only on income with a sufficient nexus to the United States.

A qualified small business corporation may elect, under subchapter S of the Code, not to be subject to the corporate income tax. If an S corporation election is made, the income of the corporation will flow through to the shareholders and be taxable directly to the shareholders. Special rules (not discussed herein) also apply to a corporation that has elected to be taxable as a regulated investment company (RIC), real estate investment trust (REIT), or real estate mortgage investment conduit (REMIC).

[19] See sec. 172(b)(1)(H). The amount of a net operating loss carried back to the fifth taxable year is subject to limitation. The election is not available to certain taxpayers, including recipients of Federal government assistance under the Emergency Economic Stabilization Act of 2008 (Pub. L. No. 110-343). Corporations that are eligible small businesses may be able to increase the carryback period for two applicable net operating losses.

The Code also specifies certain expenditures that typically may not be deducted, such as dividends paid to shareholders, expenses associated with earning tax-exempt income,[20] certain entertainment expenditures, certain executive compensation in excess of $1,000,000 per year, a portion of the interest on certain high-yield debt obligations that resemble equity, and fines, penalties, bribes, kickbacks and illegal payments.

Tax liability

A corporation's regular income tax liability generally is determined by applying the following tax rate schedule to its taxable income.[21]

Table 5.–Federal Corporate Income Tax Rates

If taxable income is:	Then the income tax rate is:
$0-$50,000	15 percent of taxable income
$50,001-$75,000	25 percent of taxable income
$75,001-$10,000,000	34 percent of taxable income
Over $10,000,000	35 percent of taxable income

The first two graduated rates described above are phased out for corporations with taxable income between $100,000 and $335,000. As a result, a corporation with taxable income between $335,000 and $10,000,000 effectively is subject to a flat tax rate of 34 percent. Also, the application of the 34-percent rate is gradually phased out for corporations with taxable income between $15,000,000 and $18,333,333, such that a corporation with taxable income of $18,333,333 or more effectively is subject to a flat rate of 35 percent.

In contrast to the treatment of capital gains in the individual income tax, no separate rate structure exists for corporate capital gains. Thus, the maximum rate of tax on the net capital gains of a corporation is 35 percent. A corporation may not deduct the amount of capital losses in excess of capital gains for any taxable year. Disallowed capital losses may be carried back three years or carried forward five years.

Corporations are taxed at lower rates on income from certain domestic production activities. This rate reduction is effected by the allowance of a deduction equal to a percentage of qualifying domestic production activities income. For taxable years beginning after 2009, the

[20] For example, the carrying costs of tax-exempt State and local obligations and the premiums on certain life insurance policies are not deductible.

[21] A "qualified personal service corporation" is simply taxed at a flat rate of 35 percent (sec. 11(b)(2)).

deduction is equal to nine percent of the income from manufacturing, construction, and certain other activities specified in the Code.[22]

Like individuals, corporations may reduce their tax liability by any applicable tax credits. Tax credits applicable to businesses include, among other things, credits for producing fuels from nonconventional sources, investment tax credits (applicable to investment in certain renewable energy property and the rehabilitation of certain real property), the alcohol and other fuels credit (applicable to production of certain alcohol fuels, ethanol and qualified cellulosic biofuel), the research credit (which expired on December 31, 2009), the low-income housing credit (applicable to investment in certain low-income housing projects), the enhanced oil recovery credit (applicable to the recovery of certain difficult-to-extract oil reserves)[23], the empowerment zone employment credit (applicable to wages paid to certain residents of or employees in empowerment zones, but which expired on December 31, 2009), the work opportunity credit (applicable to wages paid to individuals from certain targeted groups) and the disabled access credit (applicable to expenditures by certain small businesses to make the businesses accessible to disabled individuals). The credits generally are determined based on a percentage of the cost associated with the underlying activity and generally are subject to certain limitations.

Affiliated group

Domestic corporations that are affiliated through 80 percent or more corporate ownership may elect to file a consolidated return in lieu of filing separate returns. For purposes of calculating tax liability, corporations filing a consolidated return generally are treated as divisions of a single corporation; thus, the losses (and credits) of one corporation generally can offset the income (and thus reduce the otherwise applicable tax) of other affiliated corporations.

Minimum tax

A corporation is subject to an alternative minimum tax which is payable, in addition to all other tax liabilities, to the extent that it exceeds the corporation's regular income tax liability. The tax is imposed at a flat rate of 20 percent on alternative minimum taxable income in excess of a $40,000 exemption amount.[24] Credits that are allowed to offset a corporation's regular tax liability generally are not allowed to offset its minimum tax liability. If a corporation pays the alternative minimum tax, the amount of the tax paid is allowed as a credit against the regular tax in future years.

---

[22] Accordingly, a corporation is taxed at a rate of 35 percent on only 91 percent of qualifying income, resulting in an effective tax rate of 0.91 * 35, or 31.85 percent. A similar reduction applies to the graduated rates applicable to individuals with qualifying domestic production activities income.

[23] The enhanced oil recovery credit is phased out as the average wellhead price of uncontrolled domestic oil exceeds an inflation adjusted amount. The credit was completely phased out in both 2008 and 2009 (see, Notice 2008-72, 2008-43 IRB 998; Notice 2009-73, 2009-38 IRB 369).

[24] The exemption amount is phased out for corporations with income above certain thresholds, and is completely phased out for corporations with alternative minimum taxable income of $310,000 or more.

Alternative minimum taxable income is the corporation's taxable income increased by the corporation's tax 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. Among the preferences and adjustments applicable to the corporate alternative minimum tax are accelerated depreciation on certain property, certain expenses and allowances related to oil and gas and mining exploration and development, certain amortization expenses related to pollution control facilities, net operating losses and certain tax-exempt interest income. In addition, corporate alternative minimum taxable income is increased by 75 percent of the amount by which the corporation's "adjusted current earnings" exceeds its alternative minimum taxable income (determined without regard to this adjustment and the alternative tax net operating loss deduction). Adjusted current earnings generally are determined with reference to the rules that apply in determining a corporation's earnings and profits.

Treatment of corporate distributions

The taxation of a corporation generally is separate and distinct from the taxation of its shareholders. A distribution by a corporation to one of its shareholders generally is taxable as a dividend to the shareholder to the extent of the corporation's current or accumulated earnings and profits.[25] Thus, the amount of a corporate dividend generally is taxed twice: once when the income is earned by the corporation and again when the dividend is distributed to the shareholder.[26] Conversely, amounts paid as interest to the debtholders of a corporation generally are subject to only one level of tax (at the recipient level) since the corporation generally is allowed a deduction for the amount of interest expense paid or accrued.

Amounts received by a shareholder in complete liquidation of a corporation generally are treated as full payment in exchange for the shareholder's stock. A liquidating corporation recognizes gain or loss on the distributed property as if such property were sold to the distributee for its fair market value. However, if a corporation liquidates a subsidiary corporation of which it has 80 percent or more control, no gain or loss generally is recognized by either the parent corporation or the subsidiary corporation.

Accumulated earnings and personal holding company taxes

Taxes at a rate of 15 percent (the top rate generally applicable to dividend income of individuals) may be imposed upon the accumulated earnings or personal holding company income of a corporation. The accumulated earnings tax may be imposed if a corporation retains earnings in excess of reasonable business needs. The personal holding company tax may be imposed upon the excessive passive income of a closely held corporation. The accumulated

[25] A distribution in excess of the earnings and profits of a corporation generally is a tax-free return of capital to the shareholder to the extent of the shareholder's adjusted basis (generally, cost) in the stock of the corporation; such distribution is a capital gain if in excess of basis. A distribution of property other than cash generally is treated as a taxable sale of such property by the corporation and is taken into account by the shareholder at the property's fair market value. A distribution of common stock of the corporation generally is not a taxable event to either the corporation or the shareholder.

[26] This double taxation is currently mitigated by a reduced maximum tax rate of 15 percent generally applicable to dividend income of individuals.

earnings tax and the personal holding company tax are designed to ensure that both a corporate tax and a shareholder tax are effectively imposed on corporate earnings.

B. Corporate Income Tax for 2011

There are no significant changes to the Federal corporate income tax between 2010 and 2011. However, certain tax credits and special provisions applicable to corporations expire on December 31, 2010.[27]

[27] A complete list of expiring provisions is provided in *List of Expiring Federal Tax Provisions*, 2009-2020 (JCX-3-10), January 29, 2010 available at www.jct.gov. For example, for taxable years beginning after December 31, 2010 the accumulated earnings and personal holding company tax rates increase from 15 percent to 39.6 percent.

IV. SUMMARY OF ESTATE, GIFT, AND GENERATION-SKIPPING TRANSFER TAXES

General

Under present law as modified by the Economic Growth and Tax Relief Reconciliation Act of 2001 ("EGTRRA"),[28] the estate, gift, and generation-skipping transfer tax laws applicable to gifts made and for estates of decedents dying in 2010 and 2011 are not the same. Certain aspects of pre-2010 transfer tax laws, for example, are modified or repealed solely for purposes of decedents dying and gifts made in 2010, but again will apply to transfers made in years 2011 and thereafter. Therefore, this section provides a brief summary of certain laws that apply to taxable transfers that occur before, during, and after 2010.

Estate tax

For decedents dying before 2010, an estate tax is imposed on the taxable estate of any person who was a citizen or resident of the United States at the time of death and on certain property belonging to a nonresident of the United States that is located in the United States at the time of death. The estate tax is imposed on the estate of the decedent and generally is based on the fair market value of the property passing at death.[29] The taxable estate generally equals the worldwide gross estate less certain allowable deductions, including a marital deduction for certain bequests to the surviving spouse of the decedent and a deduction for certain bequests to charities.

For 2009, a unified credit of $1,455,800 was available with respect to taxable transfers at death.[30] These credits effectively exempt a total of $3.5 million in cumulative taxable transfers from the estate tax. The maximum estate tax rate in effect for decedents dying in 2009 was 45 percent.

---

[28] Pub. L. No. 107-16 (June 7, 2001).

[29] In addition to interests in property owned by the decedent at the time of death, the Federal estate tax also was imposed on (1) life insurance that was either payable to the decedent's estate or in which the decedent had an incident of ownership at death, (2) property over which the decedent had a general power of appointment at death, (3) annuities purchased by the decedent or his employer that were payable to the decedent before death, (4) property held as joint tenants, (5) property transferred by the decedent before death in which the decedent retained a life estate or over which the decedent had the power to designate who will possess or enjoy the property, (6) property revocably transferred by the decedent before death, and (7) certain transfers taking effect at the death of the decedent.

[30] The gift and estate taxes began as separate taxes but were partially unified in 1976 so that a single graduated rate schedule and a single effective exemption amount applied to an individual's cumulative taxable gifts and bequests. Under the law in effect prior to the enactment of EGTRRA, the effective exemption amount was scheduled to increase to $1 million in 2006, and the top rate on gifts and bequests was 55 percent. Changes enacted under EGTRRA partially decoupled the estate and gift taxes, such that the estate and gift tax "unified credit" resulted in a smaller exemption for gift tax purposes than for estate tax purposes beginning in 2004, although a single, common rate schedule still applied to gifts and bequests through 2009. Under EGTRRA, the gift tax effective exemption for 2002 through 2009 was fixed at $1 million, while the estate tax effective exemption increased gradually, as follows: $1 million for 2002 and 2003; $1.5 million for 2004 and 2005; $2 million for 2006 through 2008; and $3.5 million in 2009.

The estate transfer taxes are repealed for decedents dying and gifts made in 2010.

The estate, gift, and generation-skipping transfer tax provisions of EGTRRA are scheduled to sunset at the end of 2010. Therefore, the transfer tax laws as scheduled to be in effect prior to the enactment of EGTRRA generally will apply to estates of decedents dying, gifts made, and generation-skipping transfers made after December 31, 2010. This includes reinstatement of the estate tax for decedents dying after 2010. A single graduated rate schedule with a top rate of 55 percent and a single effective exemption amount of $1 million will apply for purposes of determining estate and gift tax on cumulative taxable transfers made by a taxpayer by lifetime gift or by bequest.

Gift tax

The United States generally imposes a gift tax on transfers of property by gift made by a U.S. citizen or resident, whether made directly or indirectly and whether made in trust or otherwise. Nonresident aliens are subject to the gift tax with respect to transfers of tangible real or personal property where the property is located in the United States at the time of the gift. The gift tax is imposed on the donor and is based on the fair market value of the property transferred. Deductions are allowed for certain gifts to spouses and to charities. Annual gifts of $13,000 (for 2010) or less per donor per donee generally are not subject to tax.

A unified credit of $345,800 is available with respect to taxable transfers by gifts; this credit effectively exempts a total of $1 million in cumulative taxable inter vivos gifts from gift tax. The gift tax remains in effect in 2010 with a $1 million effective exemption amount and a 35 percent rate.

The estate, gift, and generation-skipping transfer tax provisions of EGTRRA are scheduled to sunset at the end of 2010. Therefore, the transfer tax laws as scheduled to be in effect prior to the enactment of EGTRRA generally will apply to estates of decedents dying, gifts made, and generation-skipping transfers made after December 31, 2010. A single graduated rate schedule with a top rate of 55 percent and a single effective exemption amount of $1 million will apply for 2011 and thereafter for purposes of determining estate and gift tax on cumulative taxable transfers made by a taxpayer by lifetime gift or by bequest.

Generation-skipping transfer tax

For decedents dying and gifts made before 2010, a separate transfer tax was imposed on generation-skipping transfers, in addition to any estate or gift tax that is normally imposed on such transfers. This tax generally was imposed on transfers, either directly or through a trust or similar arrangement, to a beneficiary in more than one generation below that of the transferor. For 2009, the generation-skipping transfer tax was imposed at a flat rate of 45 percent on generation-skipping transfers in excess of $3.5 million.

The generation-skipping transfer taxes are repealed for decedents dying and gifts made in 2010.

The estate, gift, and generation-skipping transfer tax provisions of EGTRRA are scheduled to sunset at the end of 2010. Therefore, the transfer tax laws as scheduled to be in

effect prior to the enactment of EGTRRA generally will apply to estates of decedents dying, gifts made, and generation-skipping transfers made after December 31, 2010. This includes reinstatement of the generation-skipping transfer tax for gifts made after 2010. The generation-skipping transfer tax exemption amount will be $1 million, and the generation-skipping transfer tax rate will be 55 percent for 2011 and thereafter.

Basis considerations

Property received from a donor of a lifetime gift before, during, or after 2010 generally receives a carryover basis, which means that the basis in the hands of the donee generally is the same as the donor's basis.

Assets acquired from a decedent who died before 2010 generally received a "stepped up" basis, which generally resulted in a basis equal to fair market value on the date of the decedent's death (or on an alternate valuation date). For assets acquired from a decedent who dies in 2010, the rules providing for a stepped-up basis are repealed and replaced with the modified carryover basis rules of section 1022 of the Code. Assets acquired from a decedent who dies after 2010 generally will receive a stepped-up basis.

V. SUMMARY OF MAJOR EXCISE TAXES FOR 2010 AND 2011

The Federal tax system imposes excise taxes on selected goods and services. Generally, excise taxes are taxes imposed on a per unit or ad valorem (i.e., percentage of price) basis on the production, importation, or sale of a specific good or service. Among the goods and services subject to U.S. excise taxes are motor fuels, alcoholic beverages, tobacco products, firearms, air and ship transportation, certain environmentally hazardous activities and products, coal, telephone communications, certain wagers, and vehicles lacking in fuel efficiency. The largest excise taxes in terms of revenue (for fiscal year 2008) are those for gasoline motor fuels ($25.1 billion), diesel motor fuel ($9.4 billion), domestic air ticket taxes ($8.2 billion) and domestic cigarettes ($6.6 billion).

Revenues from certain Federal excise taxes are dedicated to trust funds (e.g., the Highway Trust Fund) for designated expenditure programs and revenues from other excise taxes (e.g., alcoholic beverages) go to the General Fund for general purpose expenditures. The excise taxes dedicated the Airport and Airway Trust Fund, which includes the ticket tax, generally are scheduled to expire on April 1, 2010.[31] The taxes dedicated to the Highway Trust Fund generally are scheduled to expire October 1, 2011. On October 1, 2011, the motor fuels tax rate will be reduced to 4.3 cents per gallon from 18.3 cents per gallon for gasoline and 24.3 cents per gallon for diesel fuel.

[31] H.R. 4853, as passed by the House, would extend these taxes at present law levels through July 3, 2010.

VI. BACKGROUND DATA

A. Historical Federal Receipts by Source

Tables 6 through 8 below show data from 1950 to 2009 on the aggregate receipts collected from the individual income tax, the corporate income tax, payroll taxes, excise taxes, the estate and gift taxes, and other receipts. Table 6 shows the aggregate revenues collected by source, in millions of dollars.

Table 7 shows the same aggregate revenues by source, but as a percentage of Gross Domestic Product ("GDP"). As a share of GDP, the individual income tax has generally oscillated around its average value of eight percent over this period of time. By contrast, corporate income taxes and excise taxes have generally declined as a share of GDP during this period, while payroll taxes have risen substantially as a share of GDP over this period. In 2009, total taxes averaged 14.8 percent of GDP, well below the average of the 1950-2009 period of 17.9 percent.

Table 8 shows Federal receipts by source as a percentage of all Federal receipts. Reflecting the same facts as above, the individual income tax has oscillated around its average share over this period of 44.8 percent, the corporate and excise taxes have declined as a percentage of all revenues, and payroll taxes have risen substantially from around 10 percent of the total in the early 1950s to levels generally varying between 35 and 40 percent in recent years. Payroll taxes as a share of all taxes reached a historic high of 42.3 percent in 2009, owing to sharp declines in individual and corporate income taxes.

Table 6.–Aggregate Federal Receipts by Source, 1950-2009
[millions of dollars]

Fiscal Year	Individual Income Tax	Corporate Income Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts	Total
1950	15,755	10,449	4,338	7,550	698	653	39,443
1951	21,616	14,101	5,674	8,648	708	870	51,616
1952	27,934	21,226	6,445	8,852	818	892	66,167
1953	29,816	21,238	6,820	9,877	881	976	69,608
1954	29,542	21,101	7,208	9,945	934	971	69,701
1955	28,747	17,861	7,862	9,131	924	926	65,451
1956	32,188	20,880	9,320	9,929	1,161	1,109	74,587
1957	35,620	21,167	9,997	10,534	1,365	1,307	79,990
1958	34,724	20,074	11,239	10,638	1,393	1,568	79,636
1959	36,719	17,309	11,722	10,578	1,333	1,588	79,249
1960	40,715	21,494	14,683	11,676	1,606	2,317	92,492
1961	41,338	20,954	16,439	11,860	1,896	1,900	94,388
1962	45,571	20,523	17,046	12,534	2,016	1,985	99,676
1963	47,588	21,579	19,804	13,194	2,167	2,228	106,560
1964	48,697	23,493	21,963	13,731	2,394	2,337	112,613
1965	48,792	25,461	22,242	14,570	2,716	3,037	116,817
1966	55,446	30,073	25,546	13,062	3,066	3,642	130,835
1967	61,526	33,971	32,619	13,719	2,978	4,009	148,822
1968	68,726	28,665	33,923	14,079	3,051	4,529	152,973
1969	87,249	36,678	39,015	15,222	3,491	5,227	186,882
1970	90,412	32,829	44,362	15,705	3,644	5,855	192,807
1971	86,230	26,785	47,325	16,614	3,735	6,450	187,139
1972	94,737	32,166	52,574	15,477	5,436	6,919	207,309
1973	103,246	36,153	63,115	16,260	4,917	7,109	230,799
1974	118,952	38,650	75,071	16,844	5,035	8,702	263,224
1975	122,386	40,621	84,534	16,551	4,611	10,387	279,090
1976	131,603	41,409	90,769	16,963	5,216	12,101	298,060
1977	157,626	54,892	106,485	17,548	7,327	11,681	355,559
1978	180,988	59,952	120,967	18,376	5,285	13,993	399,561
1979	217,841	65,677	138,939	18,745	5,411	16,690	463,302
1980	244,069	64,600	157,803	24,329	6,389	19,922	517,112
1981	285,917	61,137	182,720	40,839	6,787	21,872	599,272
1982	297,744	49,207	201,498	36,311	7,991	25,015	617,766
1983	288,938	37,022	208,994	35,300	6,053	24,256	600,562
1984	298,415	56,893	239,376	37,361	6,010	28,382	666,486
1985	334,531	61,331	265,163	35,992	6,422	30,598	734,088
1986	348,959	63,143	283,901	32,919	6,958	33,275	769,215
1987	392,557	83,926	303,318	32,457	7,493	34,536	854,353
1988	401,181	94,508	334,335	35,227	7,594	36,393	909,303
1989	445,690	103,291	359,416	34,386	8,745	39,576	991,190
1990	466,884	93,507	380,047	35,345	11,500	44,688	1,031,969
1991	467,827	98,086	396,016	42,402	11,138	39,527	1,055,041
1992	475,964	100,270	413,689	45,569	11,143	44,588	1,091,279
1993	509,680	117,520	428,300	48,057	12,577	38,206	1,154,401
1994	543,055	140,385	461,475	55,225	15,225	43,215	1,258,627
1995	590,244	157,004	484,473	57,464	14,763	47,833	1,351,830
1996	656,417	171,824	509,414	54,014	17,189	44,197	1,453,062
1997	737,466	182,293	539,371	56,924	19,845	43,341	1,579,292
1998	828,586	188,677	571,831	57,673	24,076	50,890	1,721,798
1999	879,480	184,680	611,833	70,414	27,782	53,270	1,827,454
2000	1,004,462	207,289	652,852	68,865	29,010	62,720	2,025,198
2001	994,339	151,075	693,967	66,232	28,400	57,129	1,991,142
2002	858,345	148,044	700,760	66,989	26,507	52,504	1,853,149
2003	793,699	131,778	712,978	67,524	21,959	54,383	1,782,321
2004	808,959	189,371	733,407	69,855	24,831	53,703	1,880,126
2005	927,222	278,282	794,125	73,094	24,764	56,138	2,153,625
2006	1,043,908	353,915	837,821	73,961	27,877	69,394	2,406,876
2007	1,163,472	370,243	869,607	65,069	26,044	73,566	2,568,001
2008	1,145,747	304,346	900,155	67,334	28,844	77,573	2,523,999
2009	915,308	138,229	890,917	62,483	23,482	74,576	2,104,995

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad social security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of [1] customs duties and fees, and [2] deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2011*, and JCT calculations.

Table 7.–Federal Receipts by Source, As a Percentage of GDP, 1950-2009

Fiscal Year	Individual Income Tax	Corporate Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts	Total
1950	5.8	3.8	1.6	2.8	0.3	0.2	14.4
1951	6.8	4.4	1.8	2.7	0.2	0.3	16.1
1952	8.0	6.1	1.8	2.5	0.2	0.3	19.0
1953	8.0	5.7	1.8	2.7	0.2	0.3	18.7
1954	7.8	5.6	1.9	2.6	0.2	0.3	18.5
1955	7.3	4.5	2.0	2.3	0.2	0.2	16.5
1956	7.5	4.9	2.2	2.3	0.3	0.3	17.5
1957	7.9	4.7	2.2	2.3	0.3	0.3	17.7
1958	7.5	4.4	2.4	2.3	0.3	0.3	17.3
1959	7.5	3.5	2.4	2.2	0.3	0.3	16.2
1960	7.8	4.1	2.8	2.3	0.3	0.4	17.8
1961	7.8	4.0	3.1	2.2	0.4	0.4	17.8
1962	8.0	3.6	3.0	2.2	0.4	0.3	17.6
1963	7.9	3.6	3.3	2.2	0.4	0.4	17.8
1964	7.6	3.7	3.4	2.1	0.4	0.4	17.6
1965	7.1	3.7	3.2	2.1	0.4	0.4	17.0
1966	7.3	4.0	3.4	1.7	0.4	0.5	17.3
1967	7.6	4.2	4.0	1.7	0.4	0.5	18.4
1968	7.9	3.3	3.9	1.6	0.4	0.5	17.6
1969	9.2	3.9	4.1	1.6	0.4	0.6	19.7
1970	8.9	3.2	4.4	1.6	0.4	0.6	19.0
1971	8.0	2.5	4.4	1.5	0.3	0.6	17.3
1972	8.1	2.7	4.5	1.3	0.5	0.6	17.6
1973	7.9	2.8	4.8	1.2	0.4	0.5	17.6
1974	8.3	2.7	5.2	1.2	0.4	0.6	18.3
1975	7.8	2.6	5.4	1.1	0.3	0.7	17.9
1976	7.6	2.4	5.2	1.0	0.3	0.7	17.1
1977	8.0	2.8	5.4	0.9	0.4	0.6	18.0
1978	8.2	2.7	5.5	0.8	0.2	0.6	18.0
1979	8.7	2.6	5.6	0.7	0.2	0.7	18.5
1980	9.0	2.4	5.8	0.9	0.2	0.7	19.0
1981	9.4	2.0	6.0	1.3	0.2	0.7	19.6
1982	9.2	1.5	6.3	1.1	0.2	0.8	19.2
1983	8.4	1.1	6.1	1.0	0.2	0.7	17.5
1984	7.8	1.5	6.2	1.0	0.2	0.7	17.3
1985	8.1	1.5	6.4	0.9	0.2	0.7	17.7
1986	7.9	1.4	6.4	0.7	0.2	0.8	17.5
1987	8.4	1.8	6.5	0.7	0.2	0.7	18.4
1988	8.0	1.9	6.7	0.7	0.2	0.7	18.2
1989	8.3	1.9	6.7	0.6	0.2	0.7	18.4
1990	8.1	1.6	6.6	0.6	0.2	0.8	18.0
1991	7.9	1.7	6.7	0.7	0.2	0.7	17.8
1992	7.6	1.6	6.6	0.7	0.2	0.7	17.5
1993	7.7	1.8	6.5	0.7	0.2	0.6	17.5
1994	7.8	2.0	6.6	0.8	0.2	0.6	18.0
1995	8.0	2.1	6.6	0.8	0.2	0.7	18.4
1996	8.5	2.2	6.6	0.7	0.2	0.6	18.8
1997	9.0	2.2	6.6	0.7	0.2	0.5	19.2
1998	9.6	2.2	6.6	0.7	0.3	0.6	19.9
1999	9.6	2.0	6.6	0.8	0.3	0.6	19.8
2000	10.2	2.1	6.6	0.7	0.3	0.6	20.6
2001	9.7	1.5	6.8	0.6	0.3	0.6	19.5
2002	8.1	1.4	6.6	0.6	0.3	0.5	17.6
2003	7.2	1.2	6.5	0.6	0.2	0.5	16.2
2004	6.9	1.6	6.3	0.6	0.2	0.5	16.1
2005	7.5	2.2	6.4	0.6	0.2	0.5	17.3
2006	7.9	2.7	6.3	0.6	0.2	0.5	18.2
2007	8.4	2.7	6.3	0.5	0.2	0.5	18.5
2008	7.9	2.1	6.2	0.5	0.2	0.5	17.5
2009	6.4	1.0	6.3	0.4	0.2	0.5	14.8
1950-2009 Avg.	8.0	2.8	5.0	1.3	0.3	0.5	17.9

[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad Social Security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of (1) customs duties and fees, and (2) deposits of earnings by the Federal Reserve system.

Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2011*; Economic Report of the President, 2010, Table B-78 for fiscal year GDP Figures.

Table 8.–Federal Receipts by Source, As a Percentage of Total Revenues, 1950-2009

Fiscal Year	Individual Income Tax	Corporate Tax	Employment[1] Taxes	Excise Taxes	Estate and Gift Taxes	Other[2] Receipts
1950	39.9	26.5	11.0	19.1	1.8	1.7
1951	41.9	27.3	11.0	16.8	1.4	1.7
1952	42.2	32.1	9.7	13.4	1.2	1.3
1953	42.8	30.5	9.8	14.2	1.3	1.4
1954	42.4	30.3	10.3	14.3	1.3	1.4
1955	43.9	27.3	12.0	14.0	1.4	1.4
1956	43.2	28.0	12.5	13.3	1.6	1.5
1957	44.5	26.5	12.5	13.2	1.7	1.6
1958	43.6	25.2	14.1	13.4	1.7	2.0
1959	46.3	21.8	14.8	13.3	1.7	2.0
1960	44.0	23.2	15.9	12.6	1.7	2.5
1961	43.8	22.2	17.4	12.6	2.0	2.0
1962	45.7	20.6	17.1	12.6	2.0	2.0
1963	44.7	20.3	18.6	12.4	2.0	2.1
1964	43.2	20.9	19.5	12.2	2.1	2.1
1965	41.8	21.8	19.0	12.5	2.3	2.6
1966	42.4	23.0	19.5	10.0	2.3	2.8
1967	41.3	22.8	21.9	9.2	2.0	2.7
1968	44.9	18.7	22.2	9.2	2.0	3.0
1969	46.7	19.6	20.9	8.1	1.9	2.8
1970	46.9	17.0	23.0	8.1	1.9	3.0
1971	46.1	14.3	25.3	8.9	2.0	3.4
1972	45.7	15.5	25.4	7.5	2.6	3.3
1973	44.7	15.7	27.3	7.0	2.1	3.1
1974	45.2	14.7	28.5	6.4	1.9	3.3
1975	43.9	14.6	30.3	5.9	1.7	3.7
1976	44.2	13.9	30.5	5.7	1.7	4.1
1977	44.3	15.4	29.9	4.9	2.1	3.3
1978	45.3	15.0	30.3	4.6	1.3	3.5
1979	47.0	14.2	30.0	4.0	1.2	3.6
1980	47.2	12.5	30.5	4.7	1.2	3.9
1981	47.7	10.2	30.5	6.8	1.1	3.6
1982	48.2	8.0	32.6	5.9	1.3	4.0
1983	48.1	6.2	34.8	5.9	1.0	4.0
1984	44.8	8.5	35.9	5.6	0.9	4.3
1985	45.6	8.4	36.1	4.9	0.9	4.2
1986	45.4	8.2	36.9	4.3	0.9	4.3
1987	46.0	9.8	35.5	3.8	0.9	4.0
1988	44.1	10.4	36.8	3.9	0.8	4.0
1989	45.0	10.4	36.3	3.5	0.9	4.0
1990	45.2	9.1	36.8	3.4	1.1	4.3
1991	44.3	9.3	37.5	4.0	1.1	3.7
1992	43.6	9.2	37.9	4.2	1.0	4.1
1993	44.2	10.2	37.1	4.2	1.1	3.3
1994	43.1	11.2	36.7	4.4	1.2	3.4
1995	43.7	11.6	35.8	4.3	1.1	3.5
1996	45.2	11.8	35.1	3.7	1.2	3.0
1997	46.7	11.5	34.2	3.6	1.3	2.7
1998	48.1	11.0	33.2	3.3	1.4	3.0
1999	48.1	10.1	33.5	3.9	1.5	2.9
2000	49.6	10.2	32.2	3.4	1.4	3.1
2001	49.9	7.6	34.9	3.3	1.4	2.9
2002	46.3	8.0	37.8	3.6	1.4	2.8
2003	44.5	7.4	40.0	3.8	1.2	3.1
2004	43.0	10.1	39.0	3.7	1.3	2.9
2005	43.1	12.9	36.9	3.4	1.1	2.6
2006	43.4	14.7	34.8	3.1	1.2	2.9
2007	45.3	14.4	33.9	2.5	1.0	2.9
2008	45.4	12.1	35.7	2.7	1.1	3.1
2009	43.5	6.6	42.3	3.0	1.1	3.5
1950-2009 Avg.	44.8	15.7	27.7	7.3	1.5	3.0

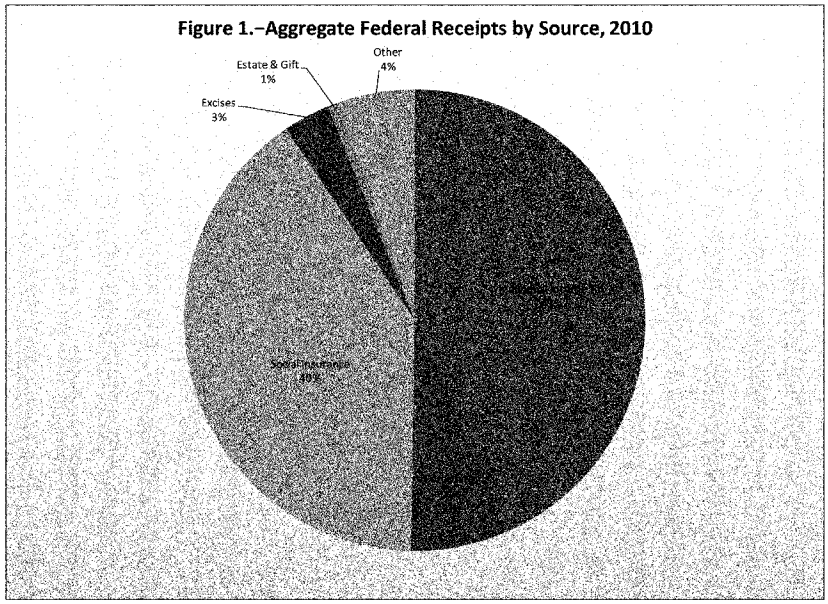
[1] Employment taxes comprise old-age and survivors insurance, disability insurance, hospital insurance, railroad retirement, railroad Social Security equivalent account, employment insurance, employee share of Federal employees retirement, and certain non-Federal employees retirement.

[2] Other receipts are primarily composed of (1) customs duties and fees, and (2) deposits of earnings by the Federal Reserve system.

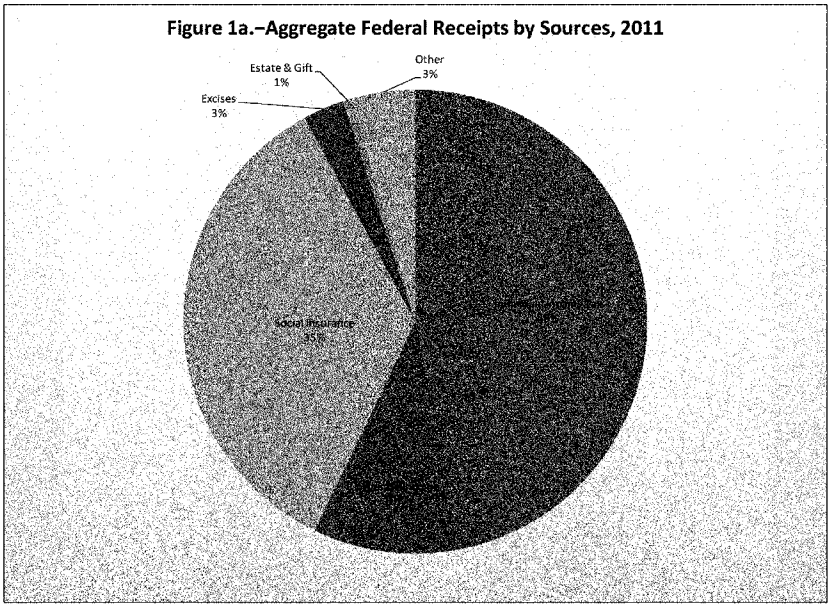
Source: Office of Management and Budget, *Historical Tables, Budget of the U.S. Government, Fiscal Year 2011.*

B. Present and Future Federal Receipts

Figure 1 and 1a, below, show aggregate Federal receipts by source for 2010 and 2011. The individual income tax and social insurance taxes are the two largest sources of revenue, with the individual income tax the larger of the two and growing relative to other sources of revenue in 2011 as a result of the expiration of numerous income tax related provisions of EGTRRA, JGTRRA, and ARRTA.

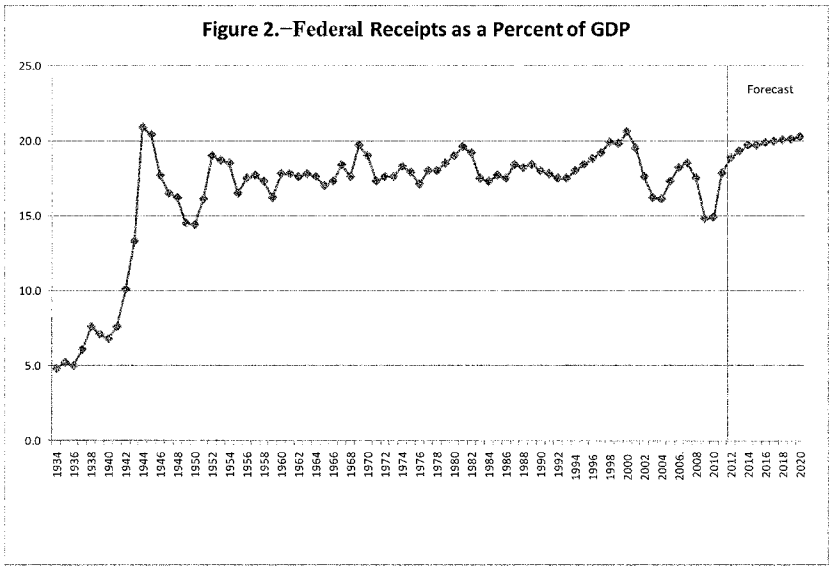


Source: Congressional Budget Office and Staff of the Joint Committee on Taxation.



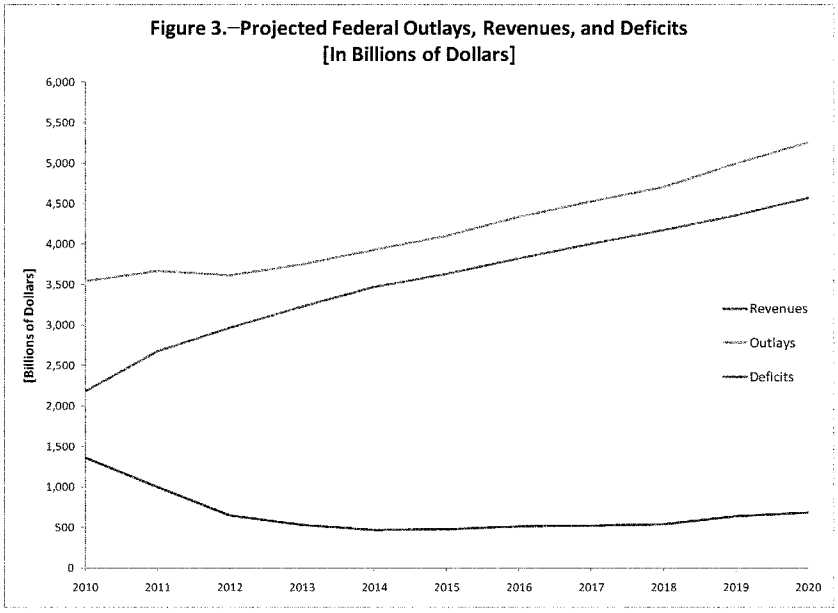
Source: Congressional Budget Office and Staff of the Joint Committee on Taxation.

Figure 2, below, shows receipts as a percentage of GDP from 1934 to the present, including projections through 2020 from the March 2010 CBO baseline of present law receipts. The drop in receipts as a percent of GDP in 2009 and 2010 to 14.8 percent and 14.9 percent, respectively, reflects the impact of both the economic recession and the legislated tax reductions of ARRTA. Receipts as a share of GDP have not been this low since 1950. The increase in receipts as a share of GDP in 2011 reflects the expiration of numerous provisions of EGTRRA, JGTRRA, and ARRTA.

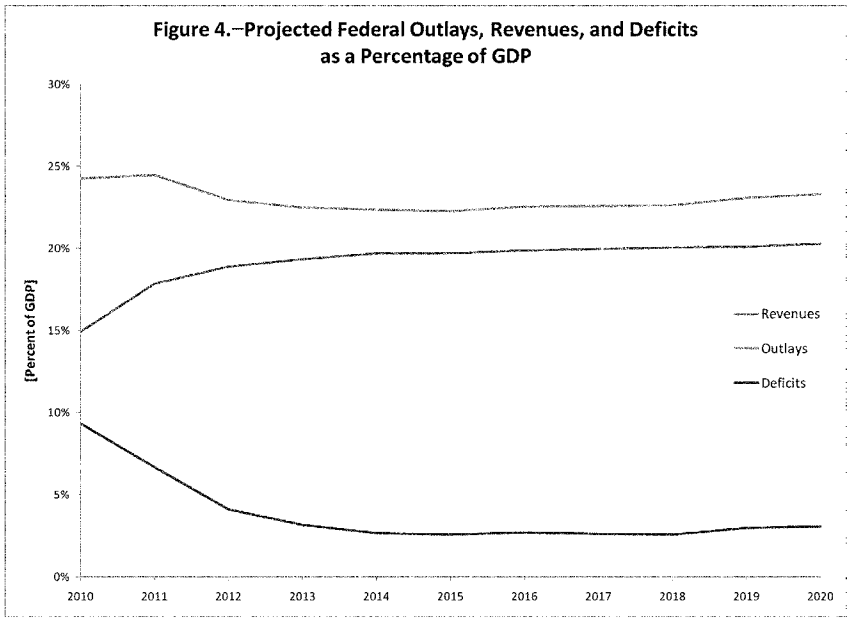


Source: Office of Management and Budget and Congressional Budget Office.

Figure 3, below, shows projected Federal Outlays, Revenues, and Deficits under the CBO March 2010 baseline, while Figure 4, below, shows the same information as a percentage of GDP. As a share of GDP, revenues rise from 14.9 percent to 20.3 percent from 2010 to 2020, outlays fall from 24.2 percent to 23.3 percent, and the deficit falls from 9.3 percent to 3.0 percent of GDP.



Source: Congressional Budget Office, March 2010 baseline.



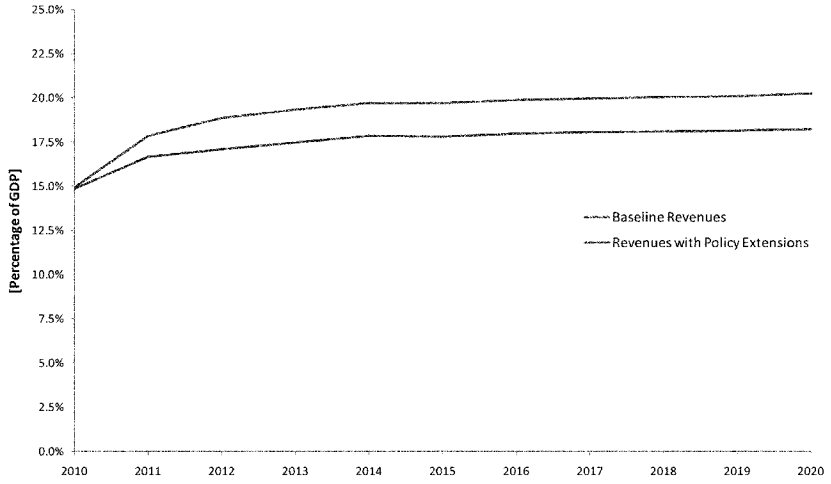
Source: Congressional Budget Office, March 2010 baseline.

Figure 5, below, shows, as a share of GDP, the baseline and projected Federal receipts under the assumption that the expiring provisions of EGTRRA and JGTRRA are extended, the estate and gift taxes are extended at 2009 parameters[32], and the parameters of the alternative minimum tax[33] are indexed for inflation from the levels in effect in 2009. By 2020, receipts are 20.3 percent of GDP under the baseline, and 18.2 percent under the policy extensions. In comparison, receipts have averaged 17.9 percent of GDP from 1950 to 2009.

[32] That is, a $3.5 million exemption amount for estates and generation skipping transfers, a gift tax exemption amount of $1 million, and a maximum rate of 45 percent.

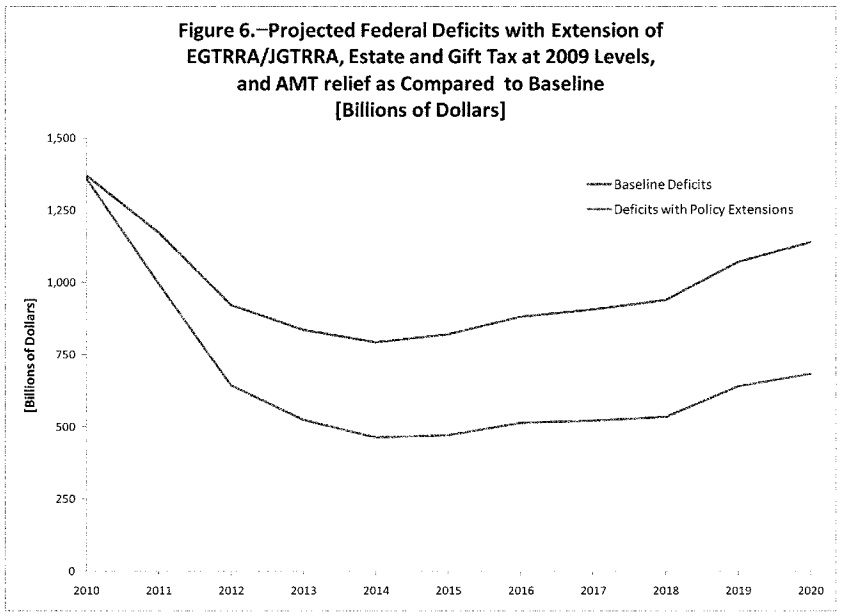
[33] The AMT parameters that are indexed include the exemption amount, the rate bracket breakpoints, and the threshold above which the exemption amount is phased out.

Figure 5.–Projected Federal Receipts with Extension of EGTRRA/JGTRRA, Estate and Gift Tax at 2009 Levels, and AMT Relief as Compared to Baseline [As a Percentage of GDP]

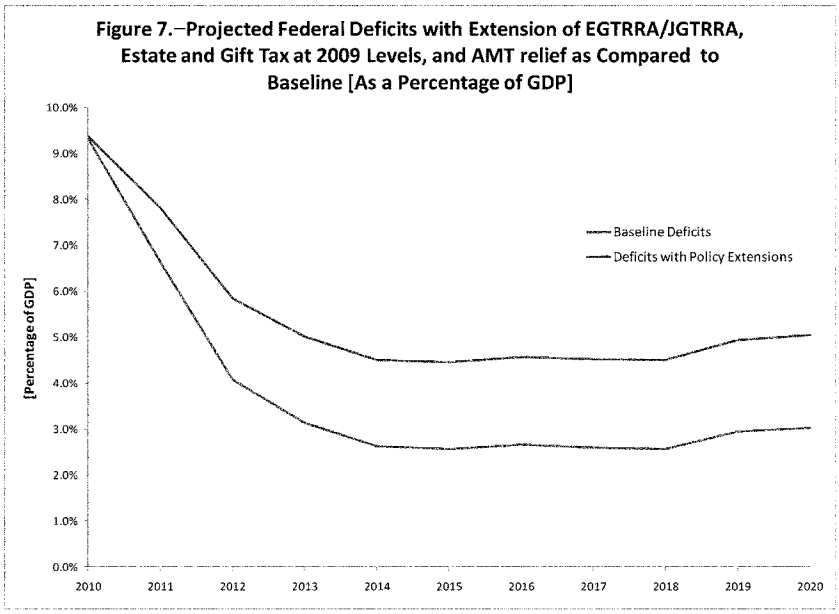


Source: Congressional Budget Office, March 2010 baseline, and staff of the Joint Committee on Taxation.

Figure 6, below, shows projected Federal deficits compared to the baseline deficit under the policy extensions described above. Figure 7 shows the same information as a percentage of GDP. With the extension of these policies, the deficit as a share of GDP is generally about 1.9 percentage points higher than under the baseline, leading to cumulative deficits of $3,498 billion from 2010 to 2020. Of this $3,498 billion, the extension of the estate and gift taxes at 2009 parameter levels accounts for $251 billion, the extension of the EGTRRA and JGTRRA provisions (excluding estate and gift provisions) accounts for $2,112 billion, and indexing the alternative minimum tax accounts for $1,135 billion (as estimated after the extension of the EGTRRA and JGTRRA provisions).



Source: Congressional Budget Office, March 2010 baseline, and staff of the Joint Committee on Taxation.

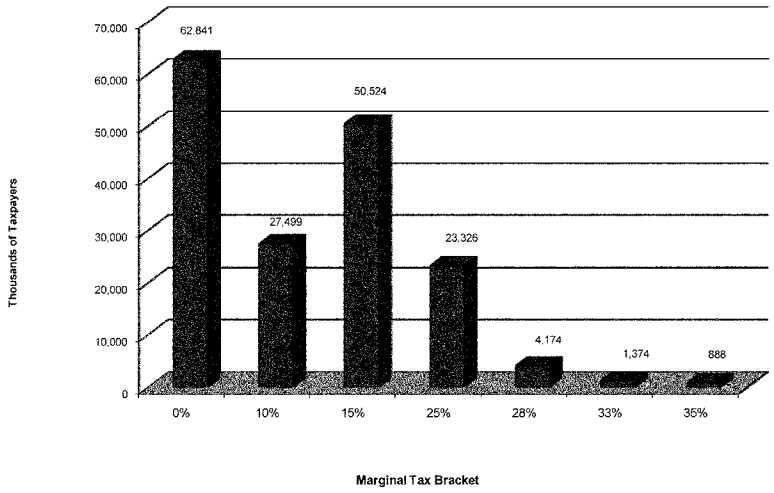


Source: Congressional Budget Office, March 2010 baseline, and staff of the Joint Committee on Taxation.

C. Selected Data Related to the Individual Income Tax in 2010 and 2011

Figure 8, below, shows the number of taxpayers by statutory marginal tax bracket for 2010. The largest single group, of slightly fewer than 63 million returns,[34] or about 37 percent of all returns, has a statutory marginal rate of zero. In contrast, slightly fewer than a million returns have a statutory marginal tax rate of 35 percent, the top marginal rate.

Figure 8.--Number of Taxpayers by Marginal Tax Rate 2010

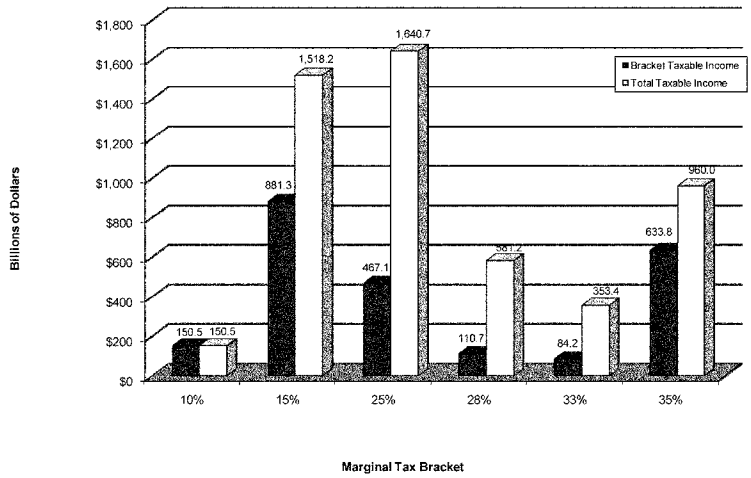


Source: Staff of the Joint Committee on Taxation.

Figure 9, below, sorts taxpayers by their marginal tax bracket (the bracket at which their last dollar of income is taxed), and shows total taxable income of taxpayers in each marginal rate bracket, as well as the taxable income in the marginal bracket alone, for 2010. Thus, for example, taxpayers with a marginal rate bracket of 28 percent have total taxable income of $581.2 billion, of which $110.7 billion is taxed at the marginal bracket of 28 percent, with the rest taxed at the lower rates of 25, 15 and 10 percent.

[34] "Returns" includes filers and nonfilers.

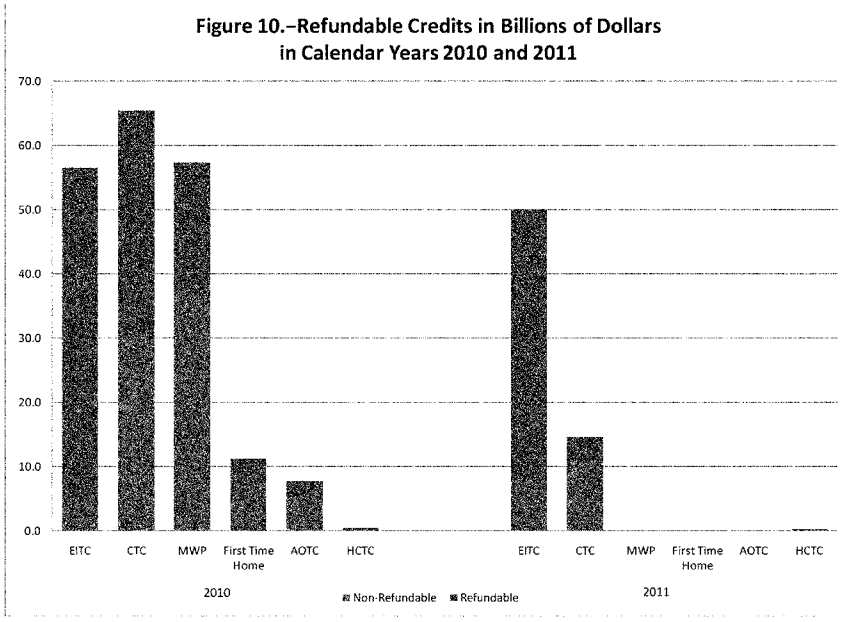
Figure 9.–Total Taxable Income of Taxpayers in Each Marginal Rate Bracket 2010



Source: Staff of the Joint Committee on Taxation.

Figure 10 shows the refundable credits for 2010 and 2011. Six principal refundable individual income tax credits are available in 2010: the earned income tax credit, the child tax credit, the making work pay credit, the first-time homebuyer credit, the American opportunity tax credit, and the health coverage tax credit. All but the child tax credit and the American opportunity tax credit are fully refundable credits. In 2011, the making work pay credit, the first-time homebuyer credit, and the American opportunity tax credit expire (the latter reverts to the Hope credit of prior law). Additionally, the child tax credit, the earned income tax credit, and the health coverage tax credit are reduced as a result of the expiration of provisions of EGTRRA and ARRTA. In 2010, the aggregate amount of all refundable credits claimed is estimated to be $188.2 billion, of which $98 billion is estimated to represent the refundable portion. In 2011, the aggregate amount of all refundable credits claimed is estimated to be $66.2 billion, of which $45 billion is estimated to represent the refundable portion.[35]

[35] The aggregate totals do not sum to the individual estimates in Figure 10 as a result of interactions among the refundable credits. The separately estimated credits as shown in Figure 10 are as follows in billions of dollars (refundable portion in parentheses) for 2010: earned income tax credit $56.5 ($51.1); the child tax credit $54.6 ($35.0); the making work pay credit $56.6 ($19.0), the first-time homebuyer credit $11.2 ($3.7), the American opportunity tax credit $9.9 ($2.5), and the health coverage tax credit $0.4 ($0.3). The figures for 2011 are: earned income tax credit $50.0 ($42.1); the child tax credit $14.6 ($4.2); and the health coverage tax credit $0.2 ($0.2).



Source: Staff of the Joint Committee on Taxation.

Table 9, below, shows by income group the number of returns that owe income tax, the number with no income tax liability, and the number with negative income tax liability (that is, they receive refundable credits that more than offset their tax liability before credits). The table shows that a taxpayer is more likely to owe tax the greater is his or her income.

Table 9 also shows by income group the number of taxpayers who claim itemized deductions. Because many deductions are likely to rise with income (State and local income taxes, for example), taxpayers with greater income are more likely to have deductions that exceed the standard deduction, and thus they will choose to itemize rather than take the standard deduction.

Table 9.–Distribution of Taxpayers by Tax Liability and Itemized Deduction Status
Tax Year 2010

Income Category (1)	Total Returns (2)	Returns with positive liability		Returns with itemized deductions		Returns with negative liability	Returns with zero liability
	Number	Number	Percentage of all returns	Number	Percentage of all returns		
Less than $10,000	28,197	90	0.3%	450	1.6%	10,661	17,447
$10,000 to $20,000	23,872	3,822	16.0%	1,081	4.5%	11,401	8,648
$20,000 to $30,000	18,456	6,845	37.1%	2,221	12.0%	8,608	3,003
$30,000 to $40,000	15,769	8,601	54.5%	3,461	21.9%	5,758	1,411
$40,000 to $50,000	12,970	9,102	70.2%	4,531	34.9%	3,153	715
$50,000 to $75,000	23,656	19,260	81.4%	11,609	49.1%	3,221	1,175
$75,000 to $100,000	14,952	14,323	95.8%	11,221	75.0%	461	169
$100,000 to $200,000	16,748	16,528	98.7%	15,382	91.8%	141	79
$200,000 to $500,000	3,782	3,756	99.3%	3,582	94.7%	2	24
$500,000 to $1,000,000	622	620	99.7%	566	91.0%	[3]	2
$1,000,000 and over	336	333	99.1%	299	89.0%	[3]	2
Total	159,359	83,279	52.3%	54,403	34.1%	43,405	32,675

(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 2009 levels.
(2) Includes filers and nonfilers.
(3) Less than 500.

Returns are in thousands.

Source: Staff of the Joint Committee on Taxation.

Table 9a.–Distribution of Taxpayers by Tax Liability and Itemized Deduction Status Tax Year 2011

Income Category (1)	Total Returns (2)	Returns with positive liability		Returns with itemized deductions		Returns with negative liability	Returns with zero liability
	Number	Number	Percentage of all returns	Number	Percentage of all returns		
Less than $10,000	28,677	82	0.3%	498	1.7%	7,228	21,367
$10,000 to $20,000	24,172	6,199	25.6%	1,230	5.1%	7,188	10,785
$20,000 to $30,000	18,543	8,222	44.3%	2,371	12.8%	6,065	4,256
$30,000 to $40,000	15,755	10,857	68.9%	3,746	23.8%	2,615	2,283
$40,000 to $50,000	13,062	11,301	86.5%	4,967	38.0%	429	1,333
$50,000 to $75,000	23,980	21,914	91.4%	12,615	52.6%	192	1,874
$75,000 to $100,000	15,269	15,012	98.3%	10,918	71.5%	14	243
$100,000 to $200,000	16,905	16,803	99.4%	14,391	85.1%	2	100
$200,000 to $500,000	3,760	3,744	99.6%	3,497	93.0%	[3]	16
$500,000 to $1,000,000	607	606	99.8%	555	91.4%	[3]	2
$1,000,000 and over	315	314	99.7%	282	89.5%	[3]	1
Total	161,047	95,054	59.0%	55,069	34.2%	23,733	42,260

(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 2009 levels.

(2) Includes filers and nonfilers.

(3) Less than 500.

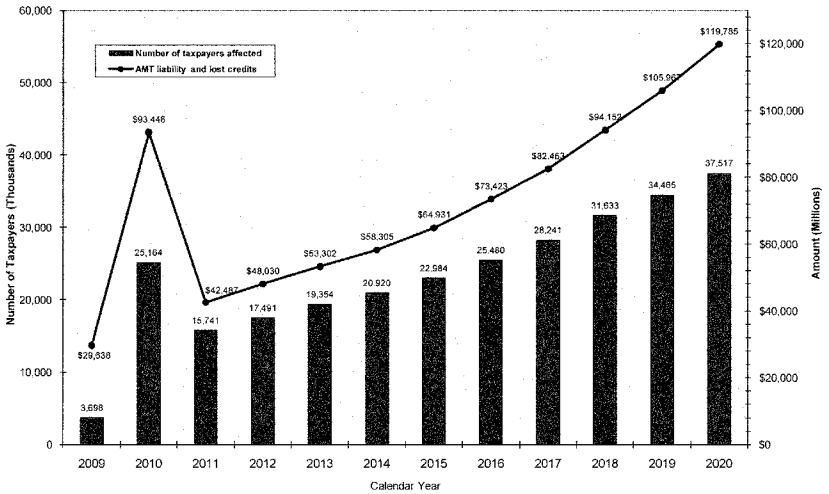
Returns are in thousands.

Source: Staff of the Joint Committee on Taxation.

Data related to the alternative minimum tax

Figure 11, below, shows the staff of the Joint Committee on Taxation's estimates of the number of taxpayers subject to the AMT under present law and the AMT liability and credits lost as a result of the AMT (certain credits are not allowed to offset a taxpayer's tentative minimum tax). The 2010 figures show a sharp rise in the revenue raised and the number of taxpayers affected as a result of the expiration of the temporary increase in the exemption levels under the AMT that expired at the end of 2009. In 2011, the number of taxpayers affected by the AMT and the AMT liability and lost credits decline as a result of the EGTRRA sunsets of the regular tax rate reductions and other provisions which reduce regular tax liability. With the rise in regular tax liability, fewer taxpayers are affected by the AMT. In 2012 and beyond, the number of taxpayers affected by the AMT and the amount of AMT liability and lost credits rises gradually as a result of the fact that the AMT is not indexed for inflation while the main parameters of the regular individual income tax are indexed for inflation.

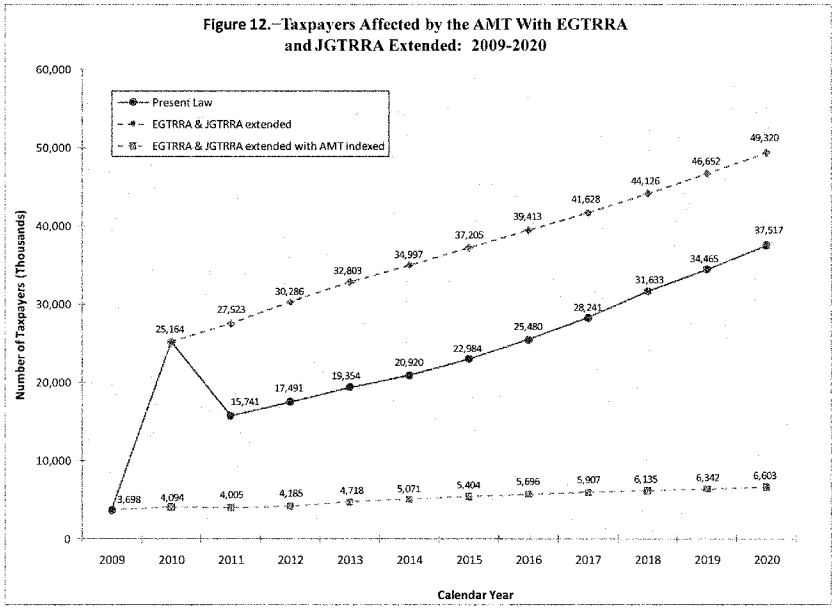
Figure 11.–Taxpayers Affected by the AMT: 2009-2020



Source: Staff of the Joint Committee on Taxation.

Figure 12, below, shows the number of taxpayers that are affected by the AMT under three alternative scenarios: (1) present law, (2) present law with the EGTRRA and JGTRRA provisions extended, and (3) present law with EGTRRA and JGTRRA provisions extended and the provisions of the AMT indexed for inflation from the 2009 levels.[36] Extending EGTRRA and JGTRRA without other changes to the AMT increases the number of taxpayers subject to the AMT and the rate of growth of the number of taxpayers subject to the AMT is similar to that which would result under present law. The indexing of the parameters of the AMT from the 2009 levels substantially reduces the number of taxpayer affected by the AMT relative to present law and substantially reduces the rate of growth of taxpayers affected by the AMT relative to present law.

[36] The provisions of the AMT that are indexed for inflation under this scenario are the exemption amounts, the rate brackets, and the beginning point of the phaseout of the exemption amount.



Source: Staff of the Joint Committee on Taxation.

Table 10, below, shows the distribution of taxpayers affected by the AMT under current law for 2010 juxtaposed with the same data if the AMT parameters in effect for 2009 were indexed for inflation. Indexing the AMT for inflation would yield exemption levels of $72,750 for married taxpayers filing jointly, $47,900 for head of household and single filers, and $36,375 for married taxpayers filing separately and for estates and trusts.

Table 10.–Taxpayers Affected by the AMT in 2010 with AMT indexing
[Returns in Thousand; Dollars in Millions]

Adjusted Gross Income	Present Law All Taxpayers			With AMT Indexing All Taxpayers		
	Returns	AMT + lost credits	Percentage of taxpayers in the income category affected by the AMT	Returns	AMT + lost credits	Percentage of taxpayers in the income category affected by the AMT
Less than $10,000	11	$214	0.02%	7	$181	0.01%
$10,000 - $20,000	15	$18	0.07%	14	$12	0.06%
$20,000 - $30,000	11	$15	0.06%	6	$11	0.03%
$30,000 - $40,000	184	$96	1.23%	3	$17	0.02%
$40,000 - $50,000	425	$294	3.66%	5	$23	0.04%
$50,000 - $75,000	3,047	$2,649	14.74%	68	$80	0.33%
$75,000 - $100,000	6,306	$8,577	49.72%	125	$253	0.99%
$100,000 - $200,000	11,547	$34,501	83.80%	986	$2,817	7.16%
$200,000 - $500,000	3,111	$33,396	96.23%	2,376	$17,146	73.49%
$500,000 - $1,000,000	400	$6,584	69.08%	399	$6,544	68.91%
$1,000,000 and above	107	$7,102	33.13%	107	$7,085	33.13%
Total	25,164	$93,446	14.75%	4,094	$34,169	2.40%

Source: Staff of the Joint Committee on Taxation.

Data related to the distribution of income and taxes[37]

For 2010, the Staff of the Joint Committee on Taxation estimates that the top 10 percent (in terms of income) of all tax returns will receive 40.2 percent of all income and pay 77.2 percent of all income taxes. The top five percent of all tax returns will receive 30.6 percent of all income and pay 64.8 percent of all income taxes. The top one percent of all tax returns will receive 17.9 percent of all income and pay 42.0 percent of all income taxes. In 2010, the income estimated to be necessary to be in the top one percent of all returns is $376,578; the top five percent requires $173,112; and the top 10 percent requires $127,768.

For 2011, the top 10 percent (in terms of income) of all tax returns will receive 39.3 percent of all income and pay 67.7 percent of all income taxes. The top five percent of all tax returns will receive 29.7 percent of all income and pay 56.7 percent of all income taxes. The top one percent of all tax returns will receive 18.6 percent of all income and pay 41.1 percent of all income taxes. In 2011, the income estimated to be necessary to be in the top one percent of all returns is $372,384; the top five percent requires $174,571; and the top 10 percent requires $129,319.

[37] See Table11 footnote 1, below, for the definition of income used herein.

Table 11, below, shows the projected distribution of income and taxes by income category for 2010 tax returns.38 For example, tax returns with $30,000 to $40,000 of income constitute 9.9 percent of all returns, 5.7 percent of all income, 3.7 percent of total taxes, 0.2 percent of individual income taxes and 7.1 percent of social insurance taxes. Similarly, tax returns with $100,000 to $200,000 of income constitute 10.5 percent of all returns, 23.3 percent of all income, 28.2 percent of total taxes, 28.6 percent of individual income taxes, and 28.0 percent of social insurance taxes.

Table 11 also shows average tax rates by income category for the individual income tax, social insurance taxes, and for total taxes (including the individual income tax, social insurance taxes and excise taxes, but not the corporate income tax). Note that the average tax rate reported here is the tax collected by the relevant tax, divided by total income (not only income subject to the relevant tax). The average tax rate for social insurance taxes is similar across most tax returns, ranging between 7.2 and 11.0 percent for tax returns with income below $500,000, with substantially lower average rates for those with income above $500,000. Because the social insurance tax rates are constant, the variation in the average rate reflects the variation in the different income groups' share of income that is subject to social insurance taxes. The average tax rate under the income tax varies widely, from a negative 10.2 percent to 22.9 percent, reflecting the existence of refundable tax credits and progressive statutory rates of tax.

[38] The income categories and measures of income used in the staff of the Joint Committee models are not directly comparable to the historical data presented earlier in this pamphlet. Additionally, the staff of the Joint Committee on Taxation does not estimate the distribution of the corporate income taxes on account of the uncertainty in the incidence of the corporate income tax. See footnotes to Table 11 for the definition of income used by the staff of the Joint Committee on Taxation.

Table 11.– Distribution of Income and Taxes, and Average Tax Rates
2010

INCOME CATEGORY (1)	Number of Returns (2) (Thousands)	Share of Returns	Income (Millions of Dollars)	Share of Income	COMBINED INCOME, SOCIAL INSURANCE, AND EXCISE TAXES UNDER PRESENT LAW (3)			INDIVIDUAL INCOME TAXES			EMPLOYMENT TAXES		
					$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate
Less than $10,000	28,197	17.7%	130,485	1.3%	6.3	0.3%	4.8%	-13.4	-1.4%	-10.2%	13.2	1.5%	10.1%
$10,000 to $20,000	23,872	15.0%	363,202	3.7%	3.6	0.2%	1.0%	-33.4	-3.6%	-9.2%	31.5	3.6%	8.7%
$20,000 to $30,000	18,456	11.6%	466,973	4.8%	34.8	1.8%	7.5%	-20.7	-2.2%	-4.4%	50.4	5.8%	10.8%
$30,000 to $40,000	15,769	9.9%	562,324	5.7%	69.3	3.7%	12.3%	1.7	0.2%	0.3%	62.1	7.1%	11.0%
$40,000 to $50,000	12,970	8.1%	593,855	6.1%	86.4	4.6%	14.5%	16.9	1.8%	2.8%	64.1	7.3%	10.8%
$50,000 to $75,000	23,656	14.8%	1,489,164	15.2%	244.3	12.9%	16.4%	75.8	8.1%	5.1%	156.5	17.9%	10.5%
$75,000 to $100,000	14,952	9.4%	1,318,004	13.5%	250.6	13.2%	19.0%	97.3	10.4%	7.4%	143.8	16.4%	10.9%
$100,000 to $200,000	16,748	10.5%	2,281,583	23.3%	532.8	28.2%	23.4%	268.7	28.6%	11.8%	245.4	28.0%	10.8%
$200,000 to $500,000	3,782	2.4%	1,079,625	11.0%	291.1	15.4%	27.0%	206.4	22.0%	19.1%	77.8	8.9%	7.2%
$500,000 to $1,000,000	622	0.4%	429,053	4.4%	112.3	5.9%	26.2%	94.8	10.1%	22.1%	16.1	1.8%	3.7%
$1,000,000 and over	336	0.2%	1,068,415	10.9%	260.8	13.8%	24.4%	244.7	26.1%	22.9%	15.3	1.7%	1.4%
Total, All Taxpayers	159,359	100.0%	9,782,685	100.0%	1,892.2	100.0%	19.3%	938.9	100.0%	9.6%	876.2	100.0%	9.0%

(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 2009 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), 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. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

Source: Staff of the Joint Committee on Taxation.

Table 11a shows the same data as Table 11, but for tax year 2011. The most notable difference is the increase in total taxes of $303 billion and an increase of 2.4 percent in the average tax rate. Individual income taxes rise by $276.9 billion, occurring mainly as a result of the sunset provisions of EGGTRA and JGTRRA, but also as a result of the expiration of provisions of ARRTA, including the making work pay credit.

Table 11a.– Distribution of Income and Taxes, and Average Tax Rates
2011

INCOME CATEGORY (1)	Number of Returns (2) (Thousands)	Share of Returns	Income (Millions of Dollars)	Share of Income	COMBINED INCOME, SOCIAL INSURANCE, AND EXCISE TAXES UNDER PRESENT LAW (3)			INDIVIDUAL INCOME TAXES			EMPLOYMENT TAXES		
					$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate	$ Billions	Percent Share	Average Tax Rate
Less than $10,000	28,677	17.8%	134,404	1.4%	11.5	0.5%	8.6%	-8.8	-0.7%	-6.6%	13.7	1.5%	10.2%
$10,000 to $20,000	24,172	15.0%	372,231	3.8%	18.8	0.9%	5.1%	-19.4	-1.6%	-5.2%	32.5	3.6%	8.7%
$20,000 to $30,000	18,543	11.5%	474,612	4.8%	56.3	2.6%	11.9%	-0.6	0.1%	-0.1%	51.6	5.7%	10.9%
$30,000 to $40,000	15,755	9.8%	569,070	5.8%	91.4	4.2%	16.1%	22.2	1.8%	3.9%	63.5	7.0%	11.2%
$40,000 to $50,000	13,062	8.1%	605,930	6.1%	107.0	4.9%	17.7%	35.1	2.9%	5.8%	66.2	7.3%	10.9%
$50,000 to $75,000	23,980	14.9%	1,528,937	15.5%	290.7	13.3%	19.0%	115.9	9.6%	7.6%	161.9	18.0%	10.6%
$75,000 to $100,000	15,269	9.5%	1,362,332	13.8%	290.8	13.3%	21.3%	131.6	10.9%	9.7%	149.1	16.5%	10.9%
$100,000 to $200,000	16,905	10.5%	2,328,914	23.6%	588.0	26.9%	25.2%	316.3	26.3%	13.6%	251.7	27.9%	10.8%
$200,000 to $500,000	3,760	2.3%	1,084,836	11.0%	307.4	14.1%	28.3%	220.7	18.3%	20.3%	79.4	8.8%	7.3%
$500,000 to $1,000,000	607	0.4%	423,737	4.3%	127.6	5.8%	30.1%	109.9	9.1%	25.9%	16.3	1.8%	3.9%
$1,000,000 and over	315	0.2%	991,475	10.0%	297.4	13.6%	30.0%	281.5	23.4%	28.4%	15.2	1.7%	1.5%
Total, All Taxpayers	161,047	100.0%	9,876,478	100.0%	2,186.7	100.0%	22.1%	1,204.3	100.0%	12.2%	901.0	100.0%	9.1%

(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 2009 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Federal taxes are equal to individual income tax (including the outlay portion of the EIC), 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. Does not include indirect effects.

(4) The average tax rate is equal to Federal taxes described in footnote (3) divided by income described in footnote (2).

Source: Staff of the Joint Committee on Taxation.

Table 12 shows, by income class, the number of tax returns paying income or social insurance taxes for which the social insurance taxes are greater than income taxes in 2010. Because of the progressive income tax structure and the generally flat structure of social insurance taxes, the likelihood social insurance taxes will exceed income taxes increases as income levels decline. Thus, for example, in the $40,000 to $50,000 income group, 86.4 percent of tax returns have social insurance taxes greater than income taxes, while in the $100,000 to $200,000 group 60.7 percent of returns have social insurance taxes greater than income taxes.

Table 12.–Tax Returns with Income or Social Insurance Taxes
2010

INCOME CATEGORY (1)	Millions of Returns	Individual Income Taxes	Employment Taxes	Returns with Employment Taxes Greater than Income Taxes	Returns with Employment Taxes Less than Income Taxes	Percentage of Returns with Employment Taxes Greater than Income Taxes
		$ Billions	$ Billions	Millions of Returns	Millions of Returns	
Less than $10,000	17.2	-13.4	13.2	17.2	[3]	99.8%
$10,000 to $20,000	16.1	-33.4	31.5	15.6	0.5	97.1%
$20,000 to $30,000	15.7	-20.7	50.4	15.1	0.6	96.0%
$30,000 to $40,000	14.4	1.7	62.1	13.2	1.2	91.5%
$40,000 to $50,000	12.3	16.9	64.1	10.5	1.8	85.3%
$50,000 to $75,000	22.5	75.8	156.5	18.3	4.2	81.5%
$75,000 to $100,000	14.8	97.3	143.8	10.7	4.0	72.7%
$100,000 to $200,000	16.7	268.7	245.4	8.5	8.1	51.2%
$200,000 to $500,000	3.8	206.4	77.8	0.1	3.6	3.1%
$500,000 to $1,000,000	0.6	94.8	16.1	[3]	0.6	2.1%
$1,000,000 and over	0.3	244.7	15.3	[3]	0.3	1.5%
Total, All Taxpayers	134.4	938.9	876.2	109.3	25.1	81.3%

(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 2009 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Less than 50,000.

Source: Staff of the Joint Committee on Taxation.

Table 12a, below, shows the same information for 2011. The principal change is the uniform increase across all income groups in the growth of income tax liability versus employment tax liability, as a result of the previously mentioned expiration of certain provisions of EGTRRA, JGTRRA, and ARRTA. The percentage of all returns with social insurance liability greater than income tax liability falls from 80.9 percent in 2010 to 76.6 percent in 2011.

Table 12a.--Tax Returns with Income or Social Insurance Taxes
2011

INCOME CATEGORY (1)	Millions of Returns	Individual Income Taxes	Employment Taxes	Returns with Employment Taxes Greater than Income Taxes	Returns with Employment Taxes Less than Income Taxes	Percentage of Returns with Employment Taxes Greater than Income Taxes
		$ Billions	$ Billions	Millions of Returns	Millions of Returns	
Less than $10,000	17.4	-8.8	13.7	17.4	[3]	99.8%
$10,000 to $20,000	16.2	-19.4	32.5	15.7	0.4	97.3%
$20,000 to $30,000	15.8	-0.6	51.6	15.0	0.8	95.1%
$30,000 to $40,000	14.4	22.2	63.5	13.0	1.4	90.2%
$40,000 to $50,000	12.5	35.1	66.2	10.4	2.1	83.2%
$50,000 to $75,000	23.0	115.9	161.9	17.1	5.9	74.4%
$75,000 to $100,000	15.1	131.6	149.1	9.7	5.4	64.1%
$100,000 to $200,000	16.9	316.3	251.7	6.6	10.3	38.9%
$200,000 to $500,000	3.7	220.7	79.4	0.1	3.7	2.5%
$500,000 to $1,000,000	0.6	109.9	16.3	[3]	0.6	1.2%
$1,000,000 and over	0.3	281.5	15.2	[3]	0.3	0.6%
Total, All Taxpayers	135.9	1204.3	901.0	104.9	31.0	77.2%

(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 2009 levels.

(2) Includes nonfilers, excludes dependent filers and returns with negative income.

(3) Less than 50,000.

Source: Staff of the Joint Committee on Taxation.

Table 13, below, shows the average marginal tax rates for labor income and for long-term capital gain income by income category for 2010. A taxpayer's marginal tax rate is the rate of tax that is owed on the last dollar of income of the taxpayer. Table 13 reports the average of the marginal tax rates of each taxpayer in the income category.

Table 13.– Marginal Tax Rates On Labor Income and Long Term Capital Gain, by Income Category 2010

INCOME CATEGORY (1)	Labor Income			Long-Term Capital Gains Income
	Average Marginal Income Tax Rate (2)	Average Marginal Employment Tax Rate (2)	Average Combine Marginal Income and Employment Tax Rate	Average Marginal Tax Rate
Less than $10,000	-10.0%	14.2%	4.2%	0.0%
$10,000 to $20,000	0.5%	14.2%	14.7%	0.2%
$20,000 to $30,000	12.9%	14.2%	27.1%	0.5%
$30,000 to $40,000	15.9%	14.2%	30.1%	0.8%
$40,000 to $50,000	16.3%	14.2%	30.5%	2.1%
$50,000 to $75,000	17.2%	14.2%	31.4%	6.1%
$75,000 to $100,000	20.6%	14.2%	34.7%	7.8%
$100,000 to $200,000	26.4%	12.1%	38.5%	15.5%
$200,000 to $500,000	31.5%	8.0%	39.4%	17.8%
$500,000 to $1,000,000	29.1%	6.6%	35.7%	15.0%
$1,000,000 and over	31.4%	6.6%	37.9%	14.8%
Total, All Taxpayers	14.4%	13.6%	28.0%	14.7%

(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 2009 levels.

(2) For individual income and employment taxes, the average marginal tax rate is equal to the change in taxes from an additional $100 of wages to each spouse with positive wages. For long-term capital gain, the average marginal tax rate equals the change in taxes from an additional 1% increase in long-term capital gains to each taxpayer with positive long-term capital gains.

Source: Staff of the Joint Committee on Taxation.

The marginal tax rates on labor income reflect the effects of the individual income tax and the social insurance taxes. They generally rise with income, reflecting the progressive nature of the individual income tax. The social insurance tax is flat to regressive,[39] reflecting the fact that the single rate of tax for the Old Age and Survivors Disability Insurance portion of social insurance taxes does not apply to earnings above an annual cap ($106,800 in 2010).[40]

The marginal tax rates on long-term capital income are lower than those for labor income, reflecting both the lower statutory rates of tax applicable to long-term capital gains and

[39] Note that this statement reflects only the tax side of social insurance, and not the linked benefits. Many analysts think it is important to consider the tax and benefits of social insurance together.

[40] As table 7 shows, the marginal social insurance tax rate is 14.2 percent rather than the sum of the employer (7.65 percent) and employee share (7.65 percent), or 15.3 percent. The reason for this is that comprehensive income includes the employer share of social insurance tax liability. Hence the marginal social insurance rate is .153 divided by 1.0765, or 14.2 percent.

the fact that social insurance taxes do not apply to capital gain income. Marginal tax rates on long-term capital gains still generally rise with the level of income, reflecting the statutory structure of the maximum rates of tax on long-term capital gain income, as well as the interaction of capital gain income with other provisions of the income tax that phase out certain tax benefits as income increases.

Table 13a, below, shows the same information as Table 13 for 2011. The staff of the Joint Committee on Taxation estimates that the combined marginal income and social insurance tax rate for all taxpayers will rise 1.7 percentage points from 2010 to 2011 as a result of the 1.7 percentage point increase in the average marginal income tax rates due to the expiration of certain provisions of EGTRRA and ARRTA. The average marginal tax rate for long-term capital gains rises to 19.3 percent from 14.7 percent in 2010, an increase of 4.6 percentage points, as a result of the expiration of the reduced capital gains rates of EGTRRA.

Table 13a.– Marginal Tax Rates On Labor Income and Long Term Capital Gain, by Income Category
2011

INCOME CATEGORY (1)	Labor Income			Long-Term Capital Gains Income
	Average Marginal Income Tax Rate (2)	Average Marginal Employment Tax Rate (2)	Average Combine Marginal Income and Employment Tax Rate	Average Marginal Tax Rate
Less than $10,000	-6.3%	14.2%	7.9%	0.8%
$10,000 to $20,000	5.5%	14.2%	19.7%	2.3%
$20,000 to $30,000	15.1%	14.2%	29.3%	6.8%
$30,000 to $40,000	16.5%	14.2%	30.8%	6.7%
$40,000 to $50,000	15.3%	14.2%	29.5%	9.6%
$50,000 to $75,000	18.6%	14.2%	32.8%	12.5%
$75,000 to $100,000	22.3%	14.2%	36.5%	15.6%
$100,000 to $200,000	26.5%	12.2%	38.7%	20.0%
$200,000 to $500,000	32.7%	8.0%	40.7%	22.3%
$500,000 to $1,000,000	37.3%	6.6%	43.9%	19.6%
$1,000,000 and over	37.5%	6.5%	44.0%	19.3%
Total, All Taxpayers	16.1%	13.6%	29.7%	19.3%

(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 2009 levels.

(2) For individual income and employment taxes, the average marginal tax rate is equal to the change in taxes from an additional $100 of wages to each spouse with positive wages. For long-term capital gain, the average marginal tax rate equals the change in taxes from an additional 1% increase in long-term capital gains to each taxpayer with positive long-term capital gains.

Source: Staff of the Joint Committee on Taxation.

Expiring Provisions of EGTRRA and JGTRRA

Table 14, below, provides a comprehensive list of the provisions of current law that will expire at the end of 2010 as a result of the sunset provisions contained in EGTRRA and JGTRRA.

TABLE 14.–PROVISIONS WITH A TERMINATION DATE IN EGTRRA[41] AND JGTRRA[42]

Provision (Code section)	Expiration Date
1. Ten percent individual income tax rate (sec. 1(i))	12/31/10
2. Reduction in other individual income tax rates.–Size of 15 percent rate bracket modified to reflect 10-percent rate, and 28 percent, 31 percent, 36 percent and 39.6 percent rates are reduced to 25 percent, 28 percent, 33 percent and 36 percent, respectively (sec. 1(i)(2))	12/31/10
3. Repeal of the personal exemptions phase-outs ("PEP") for high income taxpayers[43] (sec. 151(d)(3)(F))	12/31/10
4. Repeal of overall limitation on itemized deductions (the "Pease limitation")[44] (sec. 68(g))	12/31/10
5. Child credit.–Increase from $500 to $1,000, expand eligibility for refundable portion of the credit, alternative minimum tax ("AMT") relief, provide that child credit not treated as income or resources for purposes of benefit or	12/31/10

[41] The termination applies to all the Economic Growth and Tax Relief Reconciliation Act of 2001, Pub. L. No. 107-16, ("EGTRRA") provisions otherwise in effect on the date December 31, 2010 (EGTRRA sec. 901). The Holocaust Restitution Tax Fairness Act of 2002, Pub. L. No. 107-358, repealed the termination contained in EGTRRA with respect to the exclusion from Federal income tax for restitution received by victims of the Nazi Regime. The Pension Protection Act of 2006, Pub. L. No. 109-280, repealed the termination contained in EGTRRA with respect to the pension and IRA provisions contained in subtitles A through F of title VI of EGTRRA and with respect to the qualified tuition program provisions in section 402 of EGTRRA.

[42] Provisions relating to reduced capital gains rates and dividends taxed at capital gains rates, enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003, Pub. L. No. 108-27, ("JGTRRA"), terminate on December 31, 2010, under JGTRRA section 303 as modified by section 102 of the Tax Increase Prevention and Reconciliation Act of 2005, Pub. L. No. 109-222 ("TIPRA").

[43] The phaseout is reduced for taxable years beginning in 2006 through 2009.

[44] The limitation is phased out for taxable years beginning in 2006 through 2009.

Provision (Code section)	Expiration Date
assistance programs financed in whole or in part with Federal funds (secs. 24(a) and (b)(3)	
6. Adoption credit and adoption assistance exclusion.–Increase to $10,000 for maximum credit and maximum exclusion, special needs adoptions deemed to have $10,000 eligible expenses for purposes of credit and exclusion, increase the beginning and ending points of phase-out range for credit and exclusion, the credit is allowed against AMT (secs. 23 and 137)	12/31/10
7. Dependent care credit.–Increase of dollar limit on creditable expenses from $2,400 to $3,000 ($4,800 to $6,000 for two or more children), increase of applicable credit percentage from 30 to 35 percent, increase of beginning point of phase-out range from $10,000 to $15,000 (secs. 21(a)(2) and 21(c))	12/31/10
8. Credit for employer-provided child care (sec. 45F)	12/31/10
9. Increase of the standard deduction for married filers to double that of unmarried filers (sec. 63(c)(2)(A))	12/31/10
10. Increase of the size of 15 percent rate bracket for married filers to double that of unmarried filers (sec. 1(f)(8))	12/31/10
11. Earned income tax credit ("EITC").–Increase in the beginning point of the phase-out range for joint returns, modification of EITC treatment of amounts not includible in income, repeal of reduction of EITC for AMT liability, expansion of math error authority	12/31/10

Provision (Code section)	Expiration Date
(secs. 32(b)(2), (c)(2)(A)(i), (h), and 6213(g)(2))	
12. Education IRAs.–Increase of maximum annual contribution from $500 to $2,000, expansion of definition of qualified education expenses, increase in the size of the phase-out range for married filers to double that of unmarried filers, provision of special needs beneficiary rules, contributions by corporations and other entities, and contributions until April 15th, permitted (secs. 530(b)(1), (b)(2), (b)(4), (c)(1), (d)(2))	12/31/10
13. Employer-provided educational assistance.–Expansion to graduate education and making the exclusion permanent (sec. 127(c)(1))	12/31/10
14. Student loan interest deduction.–Increase and indexation for inflation of the phase-out ranges, repeal of the limit on the number of months that interest payments are deductible, repeal of the rule that voluntary payments of interest are not deductible (sec. 221)	12/31/10
15. Elimination of tax on awards under the National Health Service Corps Scholarship Program and the F. Edward Hébert Armed Forces Health Professions Scholarship and Financial Assistance Program (sec. 117(c)(2))	12/31/10
16. Tax-exempt bonds for educational facilities and activities.–Increase in amount of bonds qualifying for small-issuer arbitrage rebate exception, expansion of tax-exempt bond treatment to public school facilities (secs. 142(a)(13) and (k), and 148(f)(4)(D)(vii))	12/31/10

Provision (Code section)	Expiration Date
17. Reduced capital gain rates for individuals (secs. 1(h)(1)(B), 1(h)(1)(C), 55(b)(3)(B), 55(b)(3)(C), 1445(e)(1), 7518(g)(6)(A) and sec. 102 of Pub. L. No. 109-222)	12/31/10
18. Dividends of individuals taxed at capital gain rates (secs. 1(h)(11), 163(d)(4)(B), 854(a), 854(b) and 857(c) and sec. 102 of Pub. L. No. 109-222))	12/31/10
19. Repeal of collapsible corporation rules (sec. 341)	12/31/10
20. Temporary repeal of the estate and generation-skipping transfer taxes (secs. 2210 and 2264)[45]	12/31/10
21. Reduction in the maximum gift tax rate to 35 percent[46] (sec. 2502)	12/31/10
22. Treatment of certain transfers in trust as taxable gifts under section 2503 (sec. 2511(c))	12/31/10

[45] Prior to the enactment of EGTRRA, the estate and gift tax exemption amount was scheduled to rise gradually from $675,000 to $1 million between 2001 and 2006 and to be fixed at $1 million thereafter. Under section 521 of EGTRRA, before repealing the estate and generation-skipping transfer taxes for decedents dying and gifts made in 2010, the estate and generation-skipping tax exemption amounts increased to $1 million for 2002 and 2003, $1.5 million for 2004 and 2005, $2 million for 2006 through 2008 and $3.5 million for 2009. The EGTRRA estate and gift tax provisions sunset for decedents dying and gifts made after December 31, 2010, and the estate and generation-skipping tax exemption amount scheduled to be in effect under pre-EGTRRA law ($1 million for 2006 and later years) will apply. (Secs. 2010, 2505, 2631 and sec. 901 of Pub. L. No. 107-16.)

[46] Before repealing the estate and generation-skipping transfer taxes for decedents dying and gifts made in 2010, section 511 of EGTRRA reduced the maximum estate and gift tax rate from 55 percent to 50 percent for 2002, then phased down of the maximum estate and gift tax rate from 49 percent to 45 percent from 2002 through 2007. The maximum estate and gift tax rate remained at 45 percent from 2007 through 2009. Under EGTRRA, the gift tax rate is reduced to 35 percent for gifts made in 2010. The EGTRRA estate and gift tax provisions sunset for decedents dying and gifts made after December 31, 2010, and the maximum estate and gift tax rate in effect under pre-EGTRRA (55 percent) will apply. (Secs. 2001 and 2502.)

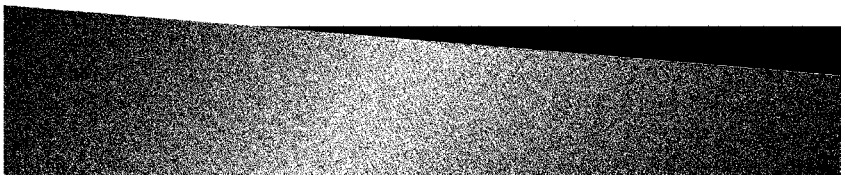
Provision (Code section)	Expiration Date
23. Repeal of the qualified family-owned business deduction (sec. 2057)	12/31/10
24. Estate tax deduction for State death taxes paid[47] (secs. 2011, 2053, 2058, 2102, 2106, and 2604)	12/31/10
25. Modified carryover basis rules for property acquired from a decedent who dies during 2010[48] (secs. 1022, 1040, 6018, and 6716)	12/31/10
26. Expansion and clarification of estate tax conservation easement rules (secs. 2031(c)(2) and (c)(8)(A)(i))	12/31/10
27. Modifications to generation-skipping transfer tax rules regarding deemed allocations of exemption to certain transfers in trust, severing of trusts, valuation, and relief for late elections (secs. 2632(c) and 2642(a)(3), (b)(1) and (b)(2)(A))	12/31/10
28. Modifications to estate tax installment payment rules (sec. 6166(b)(1)(B)(ii), (b)(1)(C)(ii), (b)(8)(B), (b)(9)(B)(iii)(I) and (b)(10))	12/31/10

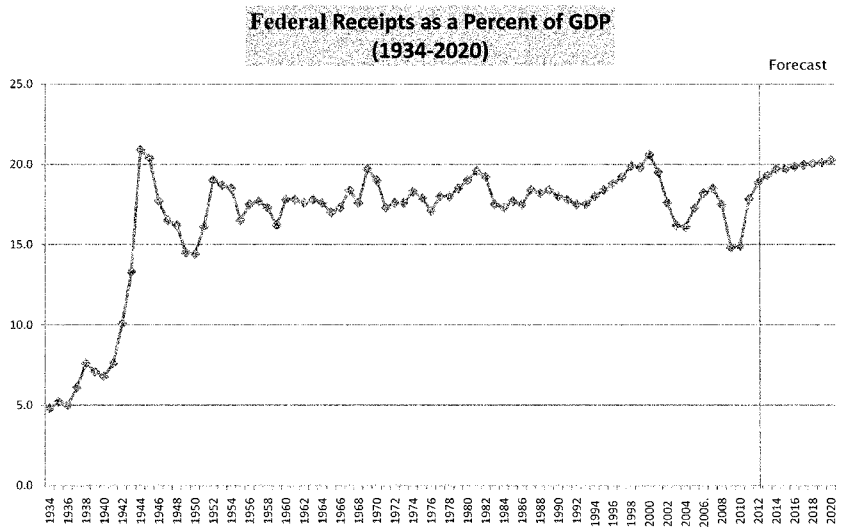
[47] Prior to 2005, an estate was allowed a credit for State death taxes paid. Sections 561-564 of EGTRRA phased down the allowable credit amount from years 2002 through 2004, before repealing the credit and replacing it with a deduction for State death taxes paid for estates of decedents dying after 2004.

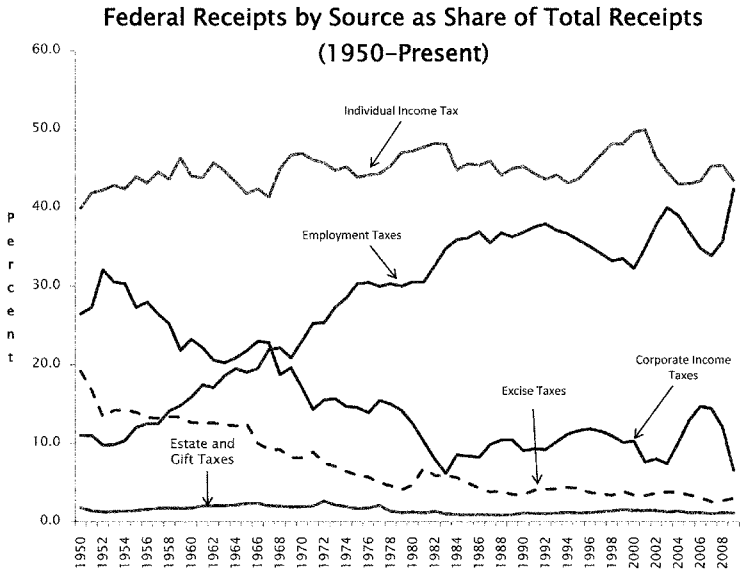
[48] Under the modified carryover basis rules in effect for decedents dying in 2010, an executor of an estate may increase, or "step-up," the basis in property passing from the estate by $1.3 million. This $1.3 million amount may be increased for certain unused built-in losses and loss carryforwards. An additional basis increase of $3 million is available for property passing to a surviving spouse. After 2010, pre-EGTRRA law applies and property acquired from a decedent will generally receive a fair market value, or "stepped-up," basis (sec. 1014).

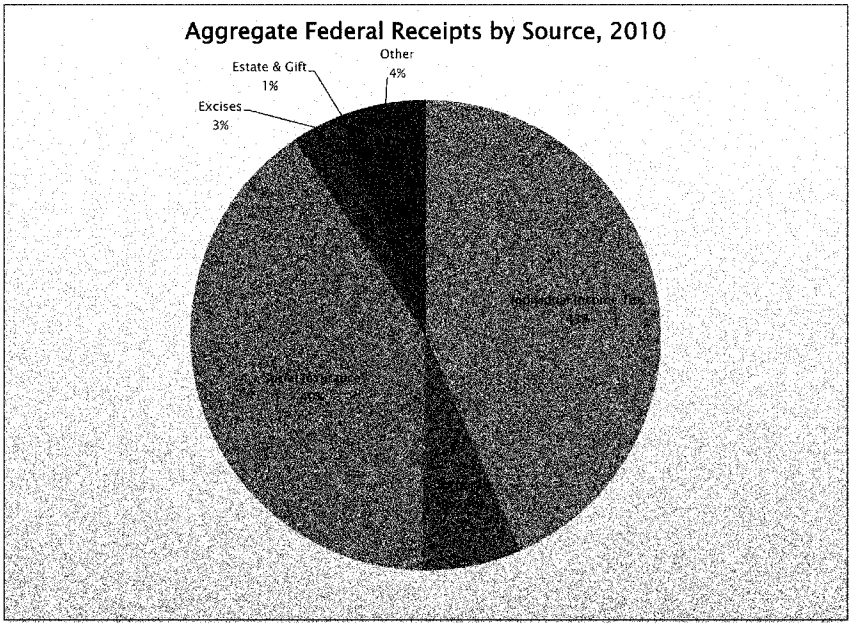
Provision (Code section)	Expiration Date
29. Tax treatment of electing Alaska Native Settlement Trusts and their beneficiaries (sec. 646)	12/31/10
30. Expansion from 90 days to 120 days the postponement of certain tax related deadlines in the case of Presidentially-declared disasters (sec. 7508A(a))	12/31/10

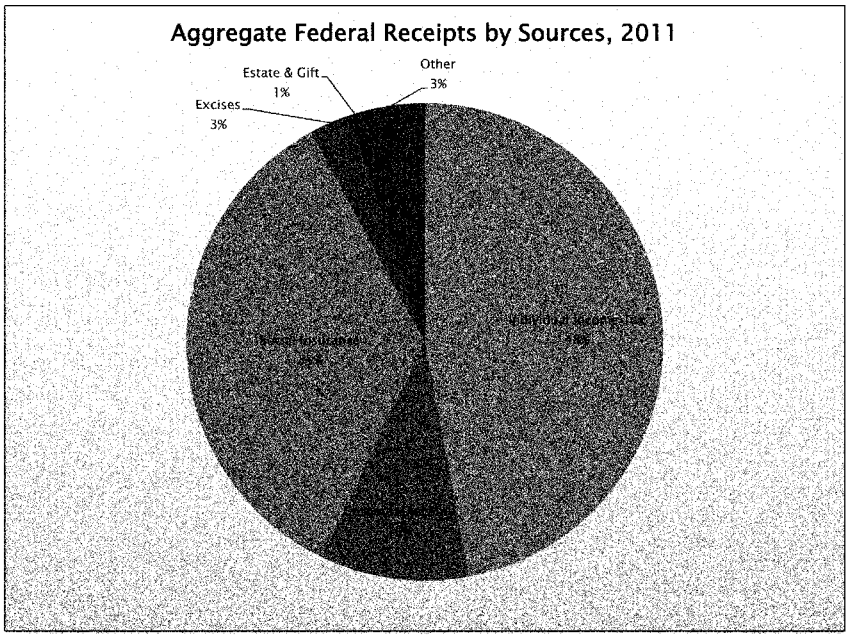
Historical and Projected Federal Receipts, and Forthcoming Changes to the Individual Income Tax in 2011



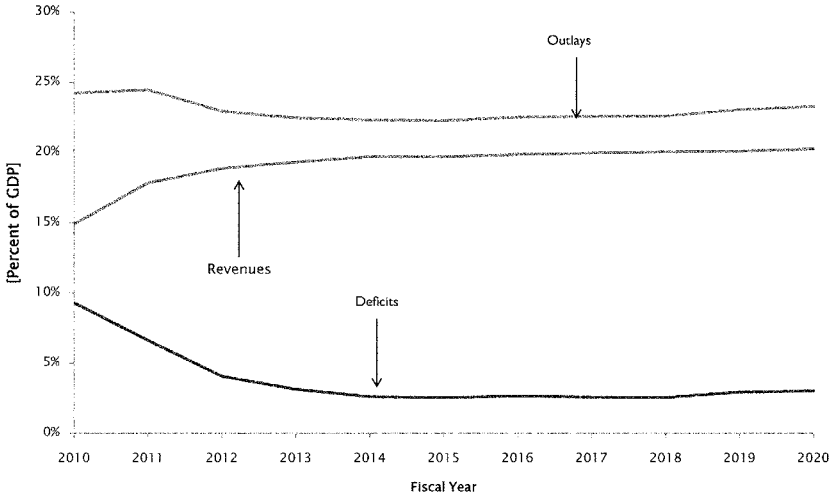

Federal Receipts as a Percent of GDP
(1934-2020)
Forecast
25.0
20.0
15.0
10.0
5.0
0.0
1934
1936
1938
1940
1942
1944
1946
1948
1950
1952
1954
1956
1958
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006.
2008
2010
2012
2014
2016
2018
2020


Federal Receipts by Source as Share of Total Receipts
(1950–Present)
Percent
60.0
50.0
40.0
30.0
20.0
10.0
0.0
Individual Income Tax
Employment Taxes
Corporate Income Taxes
Excise Taxes
Estate and Gift Taxes
1950
1952
1954
1956
1958
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980
1982
1984
1986
1988
1990
1992
1994
1996
1998
2000
2002
2004
2006
2008

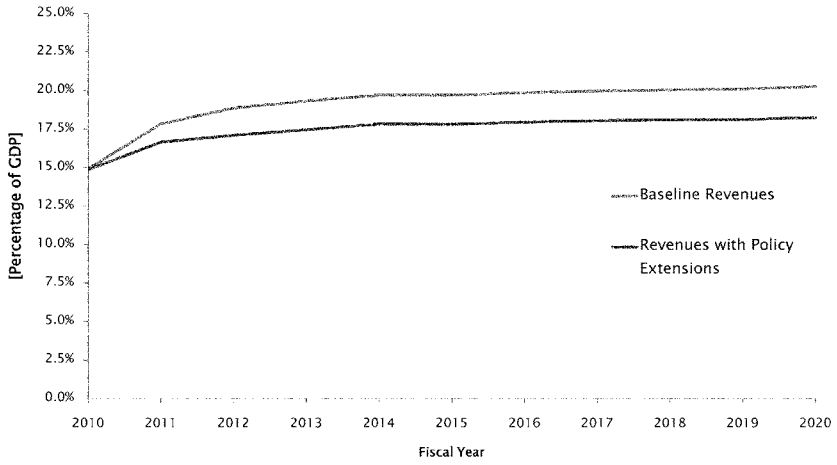

Aggregate Federal Receipts by Source, 2010
Other
4%
Estate & Gift
1%
Excises
3%

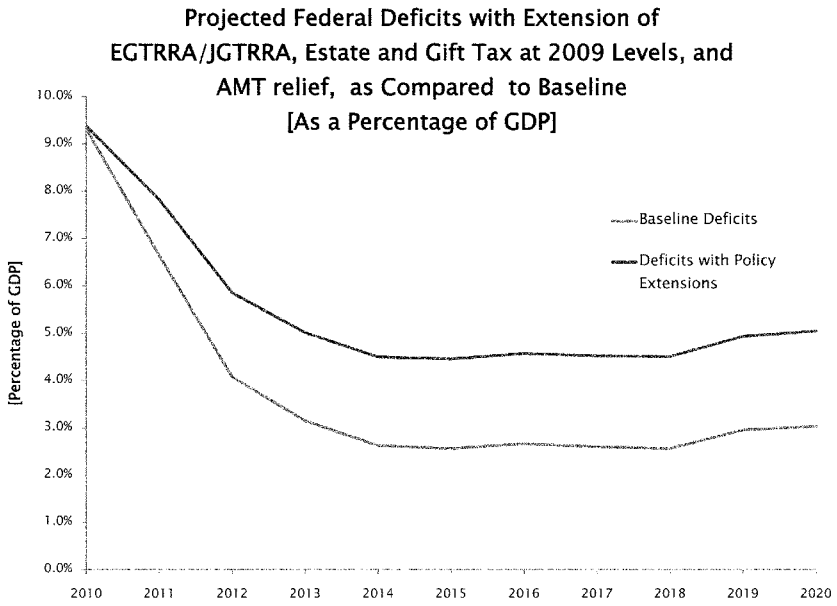

Aggregate Federal Receipts by Sources, 2011
Estate & Gift
1%
Other
3%
Excises
3%

Projected Federal Outlays, Revenues, and Deficits as a Percentage of GDP (2010-2020)



Projected Federal Receipts with Extension of EGTRRA/JGTRRA, Estate and Gift Tax at 2009 Levels, and AMT Relief as Compared to Baseline [As a Percentage of GDP]




Projected Federal Deficits with Extension of
EGTRRA/JGTRRA, Estate and Gift Tax at 2009 Levels, and
AMT relief, as Compared to Baseline
[As a Percentage of GDP]
[Percentage of GDP]
10.0%
9.0%
8.0%
7.0%
6.0%
5.0%
4.0%
3.0%
2.0%
1.0%
0.0%
2010
2011
2012
2013
2014
2015
2016
2017
2018
2019
2020
Baseline Deficits
Deficits with Policy Extensions

Personal Exemption and Basic Standard Deduction

	2010	2011
Personal Exemption	$3,650	$3,750
Basic Standard Deduction		
Married Filing Separately	$5,700	$4,875
Single	$5,700	$5,900
Head of Household	$8,400	$8,600
Married Filing Jointly	$11,400	$9,750

Regular Tax Rates

	2010	2011
Bottom Rate	10 percent →	15 percent
	15 percent →	
	25 percent →	(28 percent)
	28 percent →	31 percent
	33 percent →	36 percent
Top Rate	35 percent →	39.6 percent

Capital Gains and Dividends

	2010	2011
Gain otherwise in 10-percent or 15 percent bracket	0%	10%
Gain otherwise in 10-percent or 15 percent bracket	15%	20%
Dividends otherwise in 10-percent or 15 percent bracket	0%	15%
Dividends otherwise in brackets above 15-percent bracket	15%	28% 31% 36% 39.6%

Child Tax Credit

	2010	2011
Child Tax Credit		
Maximum	$1,000	$500
Refundable:		
Regardless of family size to extent taxpayer's earned income exceeds over $3,000	Yes	No
For families with 3 or more Children to extent taxpayer's social security taxes exceeds taxpayer's earned income	Yes	Yes

Earned Income Tax Credit Parameters

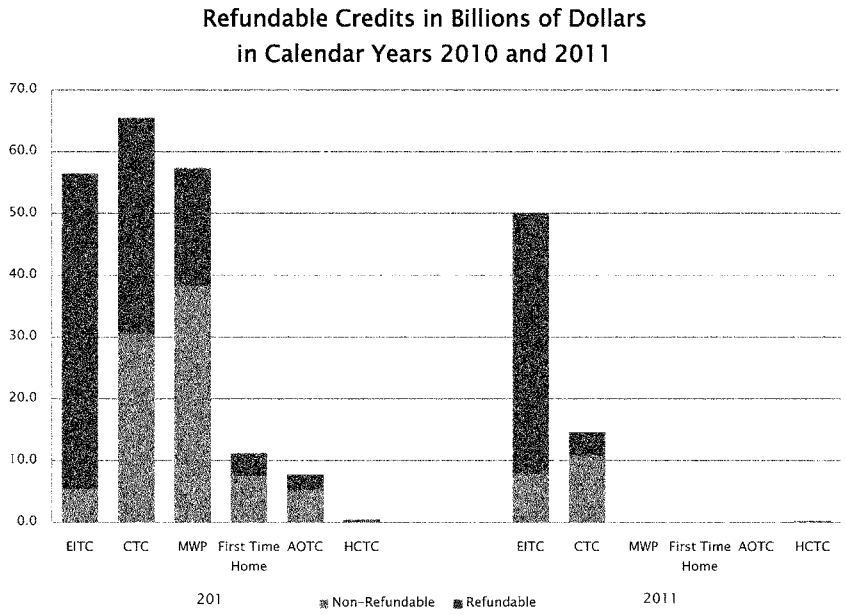
	2010	2011
Maximum Credit		
No children	$ 457	$ 463
One child	3,050	3,089
Two children	5,036	5,100
Three or more children	5,666	5,100
Phaseout Ranges for Married Taxpayers		
No children	$12,490 to $18,470	$7,580 to $13,630
One child	$21,460 to $40,545	$16,660 to $35,990
Two children	$21,460 to $45,373	$16,660 to $40,880
Three or more children	$21,460 to $48,362	$16,660 to $40,880

Certain Tax Benefits Limited/Sunsetted by EGTRRA, JGTRRA, and ARRTA

	2010	2011
Benefit of personal exemption available to higher income taxpayers ("PEP")	No	Yes
Full benefit of all itemized deductions available to higher income taxpayers ("Pease")	No	Yes
Married filers standard deduction 200% of single filers (marriage penalty relief)	Yes	No
Married filers 15-percent rate bracket size 200% of single filers (marriage penalty relief)	Yes	No
Earned Income Tax Credit ("EITC") higher phaseout point for joint filers	Yes	No

Other Income Tax Credits

	2010	2011
Health coverage tax credit percentage	80%	65%
Making work pay credit available	Yes (up to $800)	No
American Opportunity/Hope Credit		
A. Maximum credit	$2,500	$1,800
B. Number of years of college eligible	4	2
C. Phaseout range		
Single	$80,000 to $90,000	$51,000 to $61,000
Joint	$160,000 to $180,000	$102,000 to $122,000
D. Partially refundable	Yes	No
First time homebuyer credit	Yes (up to $8,000)	No

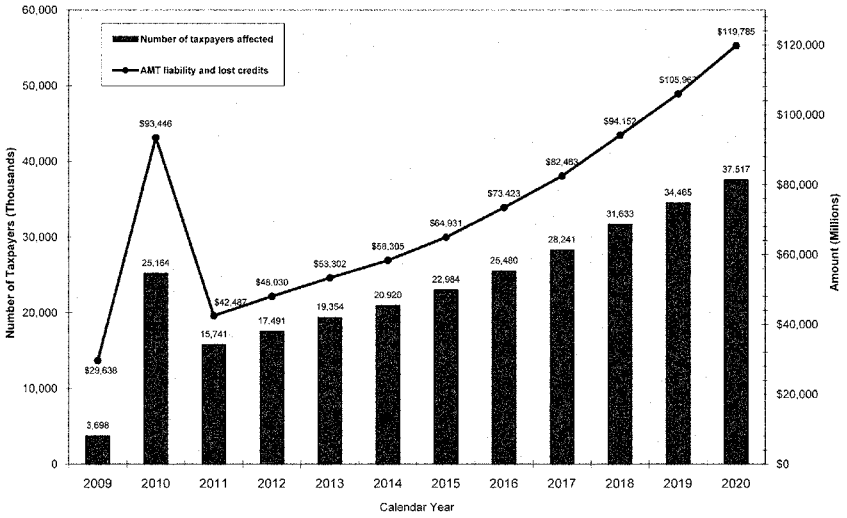

Refundable Credits in Billions of Dollars
in Calendar Years 2010 and 2011
70.0
60.0
50.0
40.0
30.0
20.0
10.0
0.0
EITC
CTC
MWP
First Time Home
AOTC
HCTC
EITC
CTC
MWP
First Time Home
AOTC
HCTC
201
2011
Non-Refundable
Refundable

Alternative Minimum Tax Exemption Levels and Taxpayers Affected Under Present Law and with AMT Indexing of 2009 Parameters

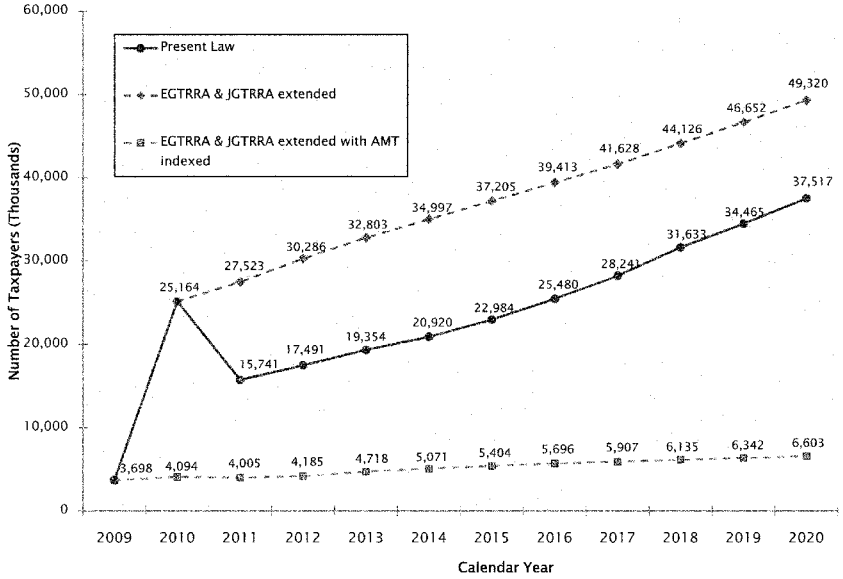
	2010 present law	2010 with indexing*
Exemption Levels		
Married taxpayers filing jointly	$45,000	$72,750
Unmarried individuals	$33,750	$47,900
Number of Taxpayers Affected	25.2 million	4.1 million

* Includes effects of indexing the exemption amount, the rate bracket breakpoints, and the threshold for phasing out the exemption amount.

Taxpayers Affected by the AMT: 2009-2020

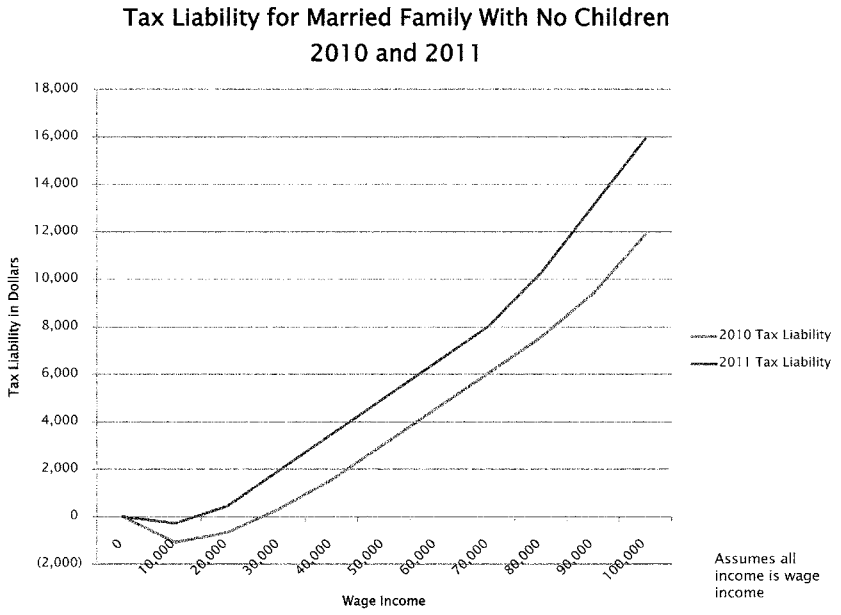


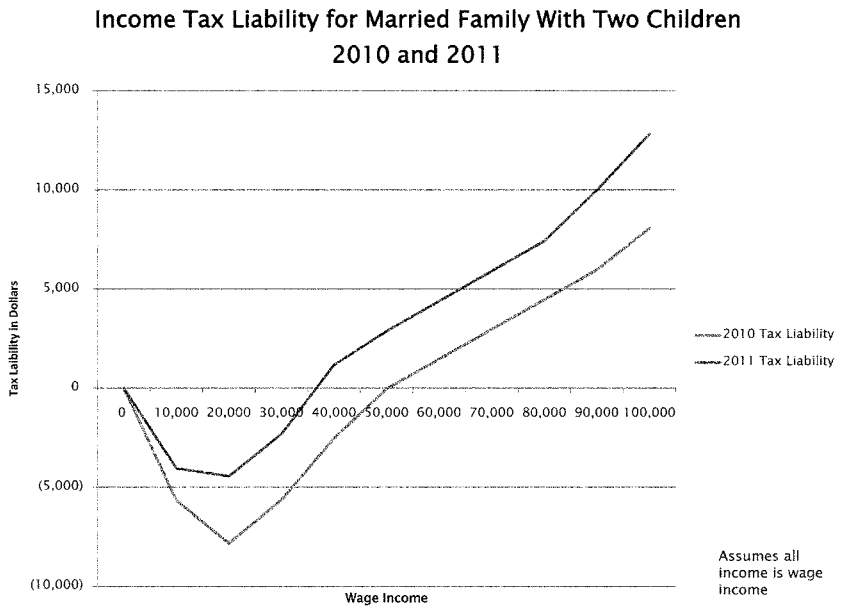
Taxpayers Affected by the AMT With EGTRRA and JGTRRA Extended: 2009-2020

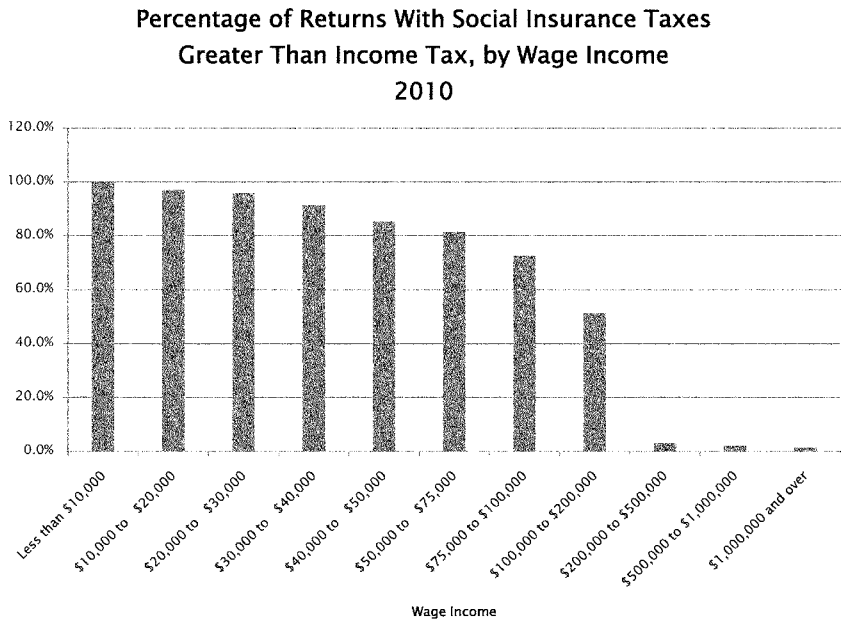


Average Tax Rates by Income Class, 2010 and 2011

INCOME CATEGORY	2010		2011	
	Average Income Tax	Average Combined Income, Excise, and Social Insurance Taxes	Average Income Tax	Average Combined Income, Excise, and Social Insurance Taxes
Less than $10,000	-10.2%	4.8%	-6.6%	8.6%
$10,000 to $20,000	-9.2%	1.0%	-5.2%	5.1%
$20,000 to $30,000	-4.4%	7.5%	-0.1%	11.9%
$30,000 to $40,000	0.3%	12.3%	3.9%	16.1%
$40,000 to $50,000	2.8%	14.5%	5.8%	17.7%
$50,000 to $75,000	5.1%	16.4%	7.6%	19.0%
$75,000 to $100,000	7.4%	19.0%	9.7%	21.3%
$100,000 to $200,000	11.8%	23.4%	13.6%	25.2%
$200,000 to $500,000	19.1%	27.0%	20.3%	28.3%
$500,000 to $1,000,000	22.1%	26.2%	25.9%	30.1%
$1,000,000 and over	22.9%	24.4%	28.4%	30.0%
Total, All Taxpayers	9.6%	19.3%	12.2%	22.1%


Tax Liability for Married Family With No Children
2010 and 2011
18,000
16,000
14,000
12,000
10,000
8,000
6,000
4,000
2,000
0
(2,000)
Tax Liability in Dollars
0
10,000
20,000
30,000
40,000
50,000
60,000
70,000
80,000
90,000
100,000
Wage Income
2010 Tax Liability
2011 Tax Liability
Assumes all income is wage income


Income Tax Liability for Married Family With Two Children
2010 and 2011
15,000
10,000
5,000
0
(5,000)
(10,000)
Tax Laibility in Dollars
0
10,000
20,000
30,000
40,000
50,000
60,000
70,000
80,000
90,000
100,000
Wage Income
2010 Tax Liability
2011 Tax Liability
Assumes all income is wage income


Percentage of Returns With Social Insurance Taxes
Greater Than Income Tax, by Wage Income
2010
120.0%
100.0%
80.0%
60.0%
40.0%
20.0%
0.0%
Less than $10,000
$10,000 to $20,000
$20,000 to $30,000
$30,000 to $40,000
$40,000 to $50,000
$50,000 to $75,000
$75,000 to $100,000
$100,000 to $200,000
$200,000 to $500,000
$500,000 to $1,000,000
$1,000,000 and over
Wage Income

Chairman NEAL. Thank you, Mr. Barthold. We have a series of votes on the floor, which are going to take about 20 minutes. So what I'd like to do is to recess the Committee until the last vote. And we'll be back as promptly as we can.

Thank you.

[Recess.]

Chairman NEAL. Could we ask our witnesses and guests to take their seats, please?

Our next witness will be Len Burman, who is the Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School at Syracuse University in the Center for Policy Research. And Pat Moynihan was one of my all-time favorite Congressional figures.

Mr. Burman.

STATEMENT OF LEN BURMAN, DANIEL PATRICK MOYNIHAN PROFESSOR OF PUBLIC AFFAIRS, MAXWELL SCHOOL AT SYRACUSE UNIVERSITY

Mr. BURMAN. Thank you, Mr. Chairman. It's actually a huge honor for me to have a chair in Senator Moynihan's name.

Chairman Neal, Ranking member Tiberi, and Members of the Subcommittee, thank you very much for inviting me to testify.

I applaud the Subcommittee for taking on the difficult but extremely important task of addressing our long-term budget challenges before disaster strikes.

My testimony makes three points. I am only going to summarize them in my oral remarks. The first, continuing the current course of enormous and growing deficits is not an option. Ignoring our budget constraints could produce an economic calamity of unprecedented proportions, a wrecked economy, confiscatory taxes, and an eviscerated government, a nightmare scenario, whatever your political preferences are.

The budget can't be tamed by spending cuts or tax increases alone. And as unpalatable as they may be, you're going to have to raise taxes. And not just on the rich.

The best way to increase tax revenues is through tax reform, in particular subjecting the nearly 200 spending programs that are run through the Tax Code, to the same scrutiny applied to direct spending.

A colleague read my testimony and said, "It's really depressing." So I'm going to try to be more upbeat in my oral remarks.

Anybody who cares about our children and our grandchildren wants to avoid catastrophic budget failure. And happily you're in a position to do it. After the very partisan and sometimes nasty health reform debate, I think the public is clamoring for bipartisanship. And deficit reduction is a great bipartisan issue.

Both sides have an enormous stake in avoiding budget catastrophe. And neither side can do it alone. Democrats and Republicans would reduce the deficit in different ways. But you have to recognize the continued stalemate and inertia as the worst possible option. And this is a case where bipartisanship is essential.

Neither tax increases nor spending cuts are politically popular. But fiscal responsibility is. And I think tax increases would be more palatable if paired with a credible commitment to control spending.

So why do I say the tax increases are inevitable? I've got a slide, which I hope will appear, showing CBO's summary of the demographic trends. Basically, they're two big issues. One is demographics, and the other is health care.

The demographics are basically that the working-age population is declining relative to the retirees, so that the share that the number of people paying for each recipient of benefits—Medicare, Medicaid, and Social Security—is declining over time. In 2010 there are 4.7 workers per retiree. By 2028, that ratio drops to three.

If you hold health care cost growth to the rate of GDP—which isn't what's happened historically—but if you could do that, primary spending—this is spending not including interest on the debt—primary spending as a share of GDP goes to 20 percent in 2012—that's after the recession is expected to be largely over—and 23 percent in 2030. And continues to creep up. That's the blue line in the chart.

So the point is that primary spending, even under the most optimistic of scenarios, is going to far exceed historical tax revenues. And spending grows at historical rates, which is about 2–1/2 percent faster than GDP, spending on health care, then the primary spending as a share of GDP would go to 25 percent in 2030 and 27 percent in 2040.

And keep in mind that this assumes this is before even accounting for the interest on the debt.

We have to slow health care cost growth. But it's unlikely to grow slower than GDP. The bottom line is that taxes as a share of GDP will have to grow, if we want to avoid a catastrophic budget failure.

So the question is, if we have to raise taxes, what's the best way to do it? I think Doug's going to talk about the problems of raising tax rates, and their effects on economic growth.

Most economists would say that the best way to increase revenues would be to broaden the base. That is, to take on tax expenditures, all of those programs, those spending programs run through the tax system, that undermine the tax base and make it harder to raise revenues.

You know, even if we wanted to raise rates as a way to deal with the deficit, the Tax Policy Center recently did a study, where they said that if we just raised the top two rates and we wanted to get the deficit down to 2 percent of GDP between 2015 and 2019, the top rate would have to increase to 91 percent. And that's before accounting for all the avoidance that would produce.

It's just not going to happen. We're not going to be able to solve the problem by raising rates just on the rich. And even raising rates across the board to get the deficit down would require top rates of over 50 percent.

And again, that's before accounting for behavioral response. And it doesn't account for the fact that spending is going to increase dramatically over time.

Well, the advantages of base-broadening as opposed to raising rates is that base broadening could actually improve economic efficiency. They reduce the opportunities for tax sheltering and avoidance, and they simplify the tax system.

And there's a big economic cost to tax compliance.

Now I know that some conservatives object to the notion of tax expenditures. They say that it assumes the government owns all your money, unless they let you keep it.

But the point about tax expenditures is that they are spending programs, and they're just run through the tax system. Some things make sense to run through the tax system. But a lot of them don't. And they should get the same kind of scrutiny that direct spending programs have.

So what I propose in the testimony—I'd be happy to discuss, if you're interested—is the idea of including tax expenditures as part of the regular budget process, that you should apply the same kind of scrutiny to low-income housing tax credit as you do to housing vouchers.

And I think you're also going to have to consider other sources of revenue. But I figure that would be a subject for another day.

Thank you very much. And I'd be happy to answer your questions.

[The prepared statement of Mr. Burman follows:]

Prepared Statement of Len Burman
Daniel Patrick Moynihan Professor of Public Affairs at the Maxwell School
Syracuse University, Center for Policy Research

Statement of

Leonard E. Burman
Daniel Patrick Moynihan Professor of Public Affairs
Maxwell School
Syracuse University

Before the
Subcommittee on Select Revenue Measures
House Ways and Means Committee

Taxes and the Budget

March 23, 2010

Chairman Neal, Ranking Member Tiberi, Members of the Subcommittee: Thank you for inviting me to share my views on taxes and the federal budget. I applaud the subcommittee for looking at the role of tax policy in dealing with our long-term budget problems.

In summary, I'd like to make three main points:

- Continuing the current course of enormous and growing deficits is not an option. Ignoring budget constraints could produce an economic calamity of unprecedented proportions. And when the budget catastrophe occurs, it will mean confiscatory taxes and an eviscerated government—a nightmare scenario whatever your political orientation.

- The budget cannot be tamed by spending cuts or tax increases alone. The retirement of the baby boomers combined with growing healthcare costs will require revenue increases if we are not to renege on our promises to seniors. But spending cannot be allowed to grow on its current path without crippling the economy.

- The best way to increase tax revenues is through tax reform—making the tax system fairer, simpler, and more conducive to economic growth. This means base broadening—and subjecting the nearly 200 spending programs that are run through the tax code to the same scrutiny applied to direct spending programs.

Avoiding Catastrophic Budget Failure

It has become a cliché to say that current budget trends are unsustainable, and to cite Herb Stein's dictum that if something can't go on forever, it will stop. Stein was clearly correct, but *how* our debt stops growing matters. The best outcome is that it stops growing because policymakers make the hard choice of cutting programs and raising taxes before the economy has suffered any real damage.

A slightly more painful option is that interest rates start to increase to reflect the increasing riskiness of government securities—because higher debt brings with it a risk that the US will either default on some of its debt or be forced to print money to avoid a default, triggering inflation or even hyperinflation. Higher interest rates would bring increasing political pressure to reduce the deficit from businesses that can't afford to invest and consumers who can't afford to borrow to buy a home or car. The downside is that the higher interest rates would also increase government's debt service costs, making the required fiscal adjustments even more painful. And higher interest rates could precipitate a recession (or stifle a nascent recovery).

The worst outcome is that interest rates show no perceptible effect from the US borrowing binge for a long time. Rates may stay low because our foreign lenders have an incentive to keep enabling our borrowing habit. The money they lend us fuels our giant trade deficit, which in turn props up their economies. If they pulled the plug, the dollar would collapse in value and US demand for foreign goods would slow to a trickle. So, in part, our debt habit simply reflects a very dangerous codependency between us and our foreign enablers.

We might hope that financial markets would save us from catastrophe by demanding higher interest rates on Treasuries, but that would require a degree of foresight that we haven't seen lately. Despite some saber rattling from bond rating agencies, our lenders have clearly calculated that Treasuries are a safe investment at low interest rates because as long as we can roll over maturing debt at low rates, we can easily pay the interest our lenders demand.

This dynamic is eerily similar to the bubble logic that overtook the housing market. Lenders concluded that as long as housing prices were growing at double digit rates, almost any borrower was worthy of a mortgage because, under the worst case scenario, the lender could foreclose and sell the house at a profit. Cheap and easy credit boosted demand for homes and kept prices soaring, fulfilling the expectations of lenders—for a while. The problem was that prices couldn't rise forever, and when they stopped, the bubble burst.

The analogy in the government bond market is that at some point investors will decide that lending to the US government is risky and demand a higher interest rate. The higher rate increases default risk as debt service becomes more burdensome, and the higher risk pushes the required interest rate up further. This vicious cycle pushes interest rates ever

higher. When the dust settles, the government may only be able to borrow at exorbitant interest rates—or possibly not at all.

That is, the market for government bonds might be a classic bubble. But when this bubble bursts, the government won't have the option to borrow to prop up financial markets if its borrowing caused the crisis.

Unable to borrow, the government will have to cut spending to the bone—including potentially devastating cuts in Social Security, Medicare, and Medicaid—and have to raise taxes to levels never before seen in this country. And even that may not be enough for forestall default. In October 2009, more than $2.5 trillion of debt had a maturity of less than one year. If the government could not roll over that debt, there is no way that it could cut spending or raise taxes fast enough to avoid default. (CBO projected total income tax revenues in 2010 to be about $1.1 trillion, so doubling the income tax—which is neither feasible nor desirable—would not close even half the gap.) As the debt grows, the amount of debt coming due each year—and the size of the potential crisis—will grow as well.

Thus, the Federal Reserve would have to serve as the "lender of last resort" for the US government, massively expanding the money supply. If the bubble burst tomorrow, the Fed might be able to plausibly commit to tightening the money supply in the near future as the federal government ran surpluses to buy back the debt. If investors believed this, we might avoid hyperinflation. But even in this case, investors might be skeptical of any promise of fiscal responsibility from the government that precipitated the crisis. And if the debt were twice as big when the bubble bursts, the government would have no credibility at all.

The consequence would likely involve a long and severe recession or depression and hyperinflation. In their survey of financial crises through the ages, Carmen Reinhart and Ken Rogoff (2009) reported that the average debt crisis of the sort we're likely to experience came with inflation of 9000 percent. That is, after the crisis, a dollar might be worth a little more than a penny.

Bottom line: catastrophic budget failure would involve hyperinflation, an eviscerated public sector, taxes that would make a Scandinavian revolt, and a crippled economy. Avoiding that fate should be your highest priority.

Tax Increases are Inevitable

Nobody likes to pay taxes, but there is no practical way to tame the debt without higher taxes unless you are willing to renege on promises made to seniors. Figure 1 summarizes the demographic challenge facing the nation. There are currently about 4.7 working age individuals (ages 20-64) for every person of retirement age (65 and older). But, as the baby boomers reach retirement age, that number plummets to 4.0 in 2018 and just 3.0 in 2028. Some refer to the inverse of this ratio as the "dependency ratio"—a measure of how many retirees depend on Social Security and Medicare for each person working and

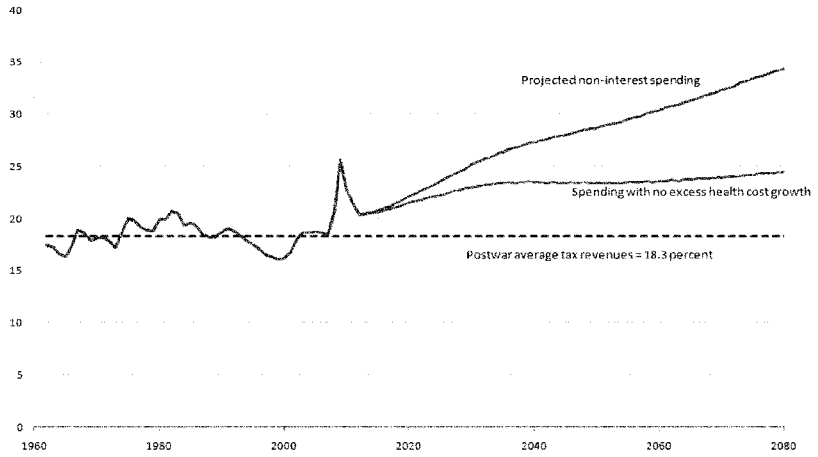
paying into the system. Even if health care costs weren't growing faster than the rest of the economy, the swelling dependency ratio would require the dwindling share of workers to shoulder larger burdens.

Figure 1. Ratio of Working Age Individuals to Retirees, 1962-2080

Source: Congressional Budget Office, 2009.

The consequence is that either taxes must increase significantly above historic levels to prevent enormous accumulations of public debt, or that government services, especially those benefiting the elderly, must be cut substantially below current levels. Figure 2 shows that even if health care costs grew at the same rate as the economy from 2009 on (rather than the historical average of 2.5 percent per year faster than GDP), primary spending—excluding interest on the debt—would still escalate rapidly from 20 percent of GDP in 2012 because of the demands of aging baby boomers. By 2030, spending would reach 23 percent of GDP. If revenues were kept at their post-war average level of 18.3 percent of GDP, deficits, the debt, and interest payments on the debt would soar.

Figure 2. Projected Non-Interest Federal Spending with and without Excess Health Costs, as Percent of GDP, 2062-2080



Source: Congressional Budget Office, 2009.

In reality, healthcare spending has grown much faster than GDP for decades—by an average of 2.5 percentage points. If it continues to follow that path, spending will increase dramatically. CBO projects that total federal primary spending will exceed 25 percent of GDP by 2030 and top 27 percent by 2040.[1] Clearly, healthcare spending will have to slow or households and governments at all levels will be bankrupted. It is highly unlikely, however, that we can hold the rate of growth of health costs below that of the economy. One reason is that a significant share of healthcare spending has paid for valuable innovations that have improved the quality and length of life. Artificial joint replacements that preserve pain-free mobility for older people are the classic example. Cutler (2005) argues that, given the potential benefits, we are not spending enough on healthcare. Cohen *et al* (2008) argue that spending on preventive care is far below optimum, and Liebman and Zeckhauser (2008) explain why human foibles (procrastination and the tendency to undervalue future benefits relative to current costs) lead people to consume too little healthcare.

Thus, while it is essential that healthcare costs be restrained over the long term, it may be neither feasible nor desirable to shrink healthcare spending as a share of the economy.

[1] As alarming as these estimates are, they assume that discretionary spending both for defense and non-defense purposes will decline as a share of GDP. If that is not true, for example, because of the costs of addressing future security threats or maintaining our crumbling infrastructure, spending could be even higher. The estimates also do not include the effects of healthcare legislation currently being considered by Congress, which could add to or reduce deficits depending on the ultimate design.

Furthermore, tremendous uncertainty exists about future health technology and spending patterns, but past experience is not encouraging. It is highly likely that health spending will compound the long-term budget problem.

It is tempting to wish that we will grow out of the problem, but that is implausible. Most of the factors that have boosted output over the past few decades are unlikely to repeat. For example, the tremendous increase in women's labor force participation was a one-time event.[2]

The greater risk is that swelling national debt will slow economic growth. Reinhart and Rogoff (2010) calculated that countries with debt above 90 percent of GDP grow by an average of 1.3 percentage points per year slower than less debt-ridden countries. (The debt-to-GDP ratio is currently about 60 percent of GDP; CBO projects it will reach 90 percent around 2020 under current policies.) If growth slows, all of the economic challenges that we face will worsen.

Taxes and Economic Growth

With few exceptions, taxes entail economic costs.[3] Some supply-siders have even contended that cuts in marginal tax rates could pay for themselves because the economy would grow faster and generate more tax revenues. Serious analyses of supply-side tax cuts, even by those very sympathetic to the premise that tax cuts can boost economic growth, have all concluded that deficit-financed tax cuts do not pay for themselves over the long run.[4] In fact, if the resulting deficits are ultimately offset by higher tax rates, the ultimate effect is likely to be lower GDP.

This occurs because the cost of taxation grows disproportionately with the tax rate. Thus, if top tax rates are cut from 40 percent to 35 percent for a while, but then raised to 45 percent to pay back the resulting debt, the 5 percentage point increase in rates reduces growth by much more than the temporary 5 percentage point rate cut boosted it.

As a general rule, stable tax rates impose less economic cost than volatile ones. For that reason, it would be far better to raise taxes soon to reduce or eliminate the deficit (after the economy has recovered from the economic downturn) than to postpone action for many years. The longer we wait, the higher tax rates would have to be to restore balance.

---

[2] For an excellent discussion of this issue, see Minarik (2010).

[3] The exceptions are where taxes mitigate a market failure, such as pollution. The scope for raising revenue from such taxes is not insignificant, but not anywhere near enough to eliminate the long-term fiscal gap.

[4] The Congressional Budget Office, Joint Committee on Taxation, and the Treasury all conducted studies in the early 2000s. They concluded that tax rate cuts could boost the economy in the short-run, but not by nearly enough to offset the direct revenue loss. The long-run effect depended on how the deficits were closed. If the deficits ultimately led to higher tax rates, GDP would be lower than without the tax cuts. If the deficits ultimately led to spending cuts, GDP would increase permanently. In all cases, the effects were small. See Gravelle (2007) for an excellent survey.

And income tax rates of 50 or 60 or 70 percent would entail huge economic costs compared with a 40 percent rate.[5]

Taxing the Rich Won't be Enough

While supply-siders hold out hope that tax cuts can somehow pay for themselves, liberals also cling to their own version of wishful thinking—that tax increases on the rich would suffice. President Obama has repeatedly promised not to raise taxes on households earning less than $250,000 per year. Rosanne Altshuler and colleagues at the Tax Policy Center (2010) estimated how much income tax rates would have to increase—assuming the rest of the Obama budget were enacted—to get the deficit down to an average of 2 percent of GDP from 2015 to 2019. They concluded that rates would have to increase by almost half: the 10-percent bracket would increase to almost 15 percent and the top bracket would increase to 52 percent—a level not seen since enactment of the Tax Reform Act of 1986.

Table 1. Rates Required to Reduce Deficit to Two Percent of GDP from 2015 to 2019

Current Tax Rates	Raise All Rates	Raise Top Three Rates	Raise Top Two Rates
10.0	14.9	10.0	10.0
15.0	22.3	15.0	15.0
25.0	37.2	25.0	25.0
28.0	41.7	60.8	28.0
33.0	49.1	71.7	85.7
35.0	52.1	76.1	90.9

If tax increases are limited to those with higher incomes, the top rates would have to become truly exorbitant to hit the 2-percent deficit target. Raising only the top 3 rates would require a top rate of 76 percent; and raising only the top 2 rates—the policy most consistent with the President's promise to spare the middle class—would require a top rate of almost 91 percent, a level not seen since the Kennedy Administration.

As Altshuler *et al* (2010) point out, those estimates do not account for the increased tax avoidance that high rates would engender. Accounting for such behavioral responses would require even higher rates. It is thus infeasible that the deficit target could be met with tax increases on the rich alone. And, given that the deficit grows ever larger, the target would grow more elusive over time.

[5] CBO estimates that allowing the Bush tax cuts to expire (raising top income tax rates to 40 percent) would reduce the primary deficit (excluding interest) to less than 2 percent of GDP until after 2030. Over the long term, further spending cuts or tax increases would be necessary, but CBO's calculations show that a top rate of about 40 percent could be consistent with a much improved fiscal situation.

Base Broadening and Deficit Reduction

Tax rate increases harm the economy and cannot, by themselves, close the budget gap. In contrast, base broadening can boost tax revenues and make the income tax more efficient, fair, and comprehensible.[6] Loopholes and preferences in the income tax complicate tax preparation and create opportunities for tax avoidance and evasion. For example, long-term capital gains face a 15-percent top rate compared with a 35 percent rate for ordinary income. The capital gains preference has created a whole tax shelter industry designed to convert highly taxed ordinary income into lightly taxed capital gains. The lower rate can distort investment and occupation choices. For example, finance experts who work in the private equity arena are taxed at less than half the rate of bond traders who may work down the hall and do very similar work. Taxing capital gains at the same rate as other income would eliminate those distortions.[7]

The numerous tax preferences in the Code and reduce tax revenues by an enormous amount—over $1 trillion a year.[8] Like healthcare expenditures, they are growing faster than the rest of the economy. Over the next 5 years, so-called "tax expenditures" will reduce federal revenues by over $9 trillion, or 74 percent of income tax revenues. Subjecting tax expenditures to the same level of scrutiny we apply to direct spending programs could improve the efficiency of the government and help tame the budget deficit. And, arguably, since tax expenditures are really just spending programs in disguise, limiting tax expenditures could be seen as consistent with the President's promise to spare the middle class from tax increases. Indeed, the President has proposed to limit cap the growth of discretionary spending. It would make sense to apply the same budget discipline to the far larger category of spending programs run through the tax system.

The concept of tax expenditures is controversial, but it has been around for decades, since Treasury Assistant Secretary Stanley Surrey proposed that deviations from the normal tax rules that serve to benefit a particular group or activity should be considered spending. The basic notion is that a $100 tax reduction for undertaking a particular activity is identical to a $100 cash grant for the subsidized activity in terms of its effect on the deficit and resource allocation.

Conservatives have objected to the notion of a tax expenditure since long before Surrey coined the term. William Gladstone, a Tory member of the British parliament, argued in

---

[6] Saez *et al* (2009) conclude that rate increases entail significant economic costs while base broadening reduces the cost of taxation. Conservative icon Martin Feldstein (2009) made the same argument in a *Wall Street Journal* op ed, arguing that additional revenues are needed and eliminating tax breaks would be far better than raising tax rates.

[7] Numerous other arguments are made for a lower tax rate on capital gains. See Burman (1999) for a discussion and critique.

[8] The estimates in this paragraph are based on the sum of the tax expenditure estimates reported in the *Analytical Perspectives* volume of the federal budget. Adding tax expenditures ignores potentially significant interactions among the different tax subsidies. Burman *et al* (2008) found that including interactions would increase the total by 5 to 8 percent. Thus, the $1.1 trillion sum of tax expenditures in 2010 is likely an underestimate of the total cost.

1863 that the government should monitor the uses of the charitable deduction allowed under the income tax, just as it would any other spending program. The rebuttal from Sir Strafford Northcote could be lifted from the modern ultraconservative's critique of tax expenditures: "The right hon. Gentleman, if he took £5 out of the pocket of a man with £100, put the case as if he gave the man £95…" (Quoted by Neil Brooks, 1986)

For some reason, modern conservatives find this talking point compelling, but I have a hard time understanding why. Virtually any spending program could be converted into a tax expenditure. Why does that sleight of hand inoculate a spending program from scrutiny? The late Princeton economist David Bradford—one of the intellectual forebears of the "flat tax"—used to quip that he could fund the Pentagon with tax expenditures (by, for example, providing refundable tax credits in lieu of cash to arms manufacturers), reducing the size of the recorded defense budget without hurting national security one bit.

To take another example, suppose we offered individuals eligible for Medicare the option of buying their insurance for an actuarially fair premium from the government, in exchange for a tax credit equal to 110% of the premium. Higher-income seniors with sufficient tax liability to use the credit would presumably take advantage of this great deal. It would cut Medicare spending, and cut taxes by even more. Government would appear to be smaller and taxes lower, but in reality, we'd only have complicated tax compliance for seniors and increased the deficit.

The growth of tax expenditures has been fueled by a political environment that favors "tax cuts" over spending, even when a spending program might be more effective. But tax expenditures strongly resemble entitlement programs and can be just as detrimental to the budget over the long term. And they often make the tax system more complex.

Monitoring tax expenditures would require a significant change in the budgeting process as most tax subsidies are now virtual entitlements, continuing (and growing) unless Congress legislates change or repeal. Former JCT chief of staff George Yin (2009) has proposed sunsetting all tax expenditures and requiring periodic reauthorization as for discretionary programs. A less radical approach would be to include the value of tax expenditures with direct expenditures and subject the totals to caps as part of the Congressional budget process. This obviously would create some jurisdictional challenges for Congress (between appropriating committees and the tax-writing committees), but it is, in my view, the only way to get total spending under control. It makes no sense to exempt more than $1 trillion of spending from budget scrutiny.

I'm certainly not proposing to eliminate all tax expenditures. It makes sense to run some programs through the tax system instead of setting up another bureaucracy. I just think we ought to subject these expenditures to the same fiscal constraint and scrutiny that the President wants to apply to other domestic spending programs.

Conclusions and Recommendations

Taming the budget will require both spending cuts and new tax revenues. The best way to raise revenues would be to broaden the base—eliminate or reform tax expenditures that are not serving their purpose with the goal of making the tax system simpler, fairer and more conducive to economic growth. As part of that process, other more efficient sources of revenue such as a VAT should be considered.

The President has signaled that his deficit reduction panel may consider tax reform as part of a package of revenue increases and spending cuts. That's a good idea. However, if Congress makes most of the Bush and Obama tax cuts permanent, as the President proposes, tax reform would become much more difficult. A better approach would be to extend the tax cuts for two or three years and commit to a real process of tax and expenditure reforms to eliminate the primary deficit by a certain date.

References

Altshuler, Rosanne, Katherine Lim, and Roberton Williams, "Desperately Seeking Revenue," Tax Policy Center, 2010.
http://www.taxpolicycenter.org/publications/url.cfm?ID=412018

Burman, Leonard E., *The Labyrinth of Capital Gains Tax Policy: A Guide for the Perplexed,* Washington, DC: The Brookings Institution Press, 1999.

Burman, Leonard E., Eric Toder, and Christopher Geissler, "How Big are Total Individual Income Tax Expenditures and Who Benefits From Them?" Tax Policy Center Discussion Paper No. 31, 2008.
http://www.taxpolicycenter.org/UploadedPDF/1001234_tax_expenditures.pdf

Brooks, Neil, "Review of Surrey and McDaniel,"*Canadian Tax Journal.* Vol. 34, no. 3, pp. 681-694, 1985.

Cohen, Joshua T., Peter J. Neumann, and Milton C. Weinstein, "Does Preventive Care Save Money? Health Economics and the Presidential Candidates, " *New England Journal of Economics*, February 14, 2008.

Cutler, David M., *Your Money or Your Life: Strong Medicine forAmerica's Health Care System,* New York: Oxford University Press, Inc., 2005.

Feldstein, Martin, "ObamaCare's Crippling Deficits," *Wall Street Journal*, September 7, 2009.

Gravelle, Jane, "Issues in Dynamic Revenue Estimating," CRS Report for Congress RL31949, U.S. Congressional Research Service, 2007.

Liebman, Jeffrey, and Richard Zeckhauser, "Simple Humans, Complex Insurance, Subtle Subsidies," in Henry Aaron and Leonard Burman, eds., *Using Tax Breaks to Reform Health Insurance: Pitfalls and Promises,* Washington, DC: Brookings Institution Press, 2008.

Minarik, Joseph, "Why the Debt Problem Can't Be Solved by Economic Growth Alone," Bipartisan Policy Center (video), 2010.
http://bipartisanpolicy.org/news/multimedia/2010/03/18/318-video

Reinhart, Carmen M., and Kenneth S. Rogoff, *This Time is Different: Eight Centuries of Financial Folly*. Princeton University Press. 2009.

Reinhart, Carmen M., and Kenneth S. Rogoff, "Growth in a Time of Debt," *The American Economic Review Papers and Proceedings*. 2010 (forthcoming)

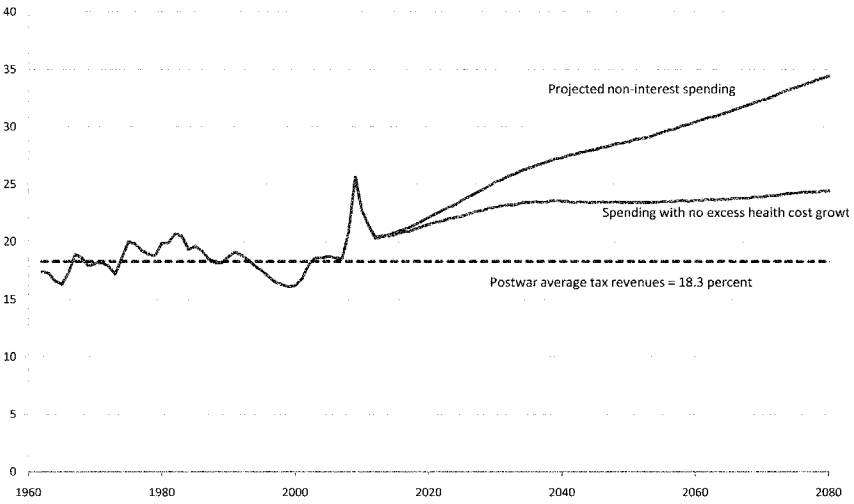
Saez, Emmanuel, Joel B. Slemrod, and Seth H. Giertz, "The Elasticity of Taxable Income with Respect to Marginal Tax Rates: A Critical Review," NBER Working Paper 15012, 2009. http://www.nber.org/papers/w15012

Yin, George K., "Temporary-Effect Legislation, Political Accountability, and Fiscal Restraint," *New York University Law Review*, Vol. 84, 2009

Figure 1. Ratio of Working Age Individuals to Retirees, 1962-2080

Source: Congressional Budget Office, 2009.

Figure 2. Projected Non-Interest Federal Spending with and without Excess Health Costs, as Percent of GDP, 2062-2080



Source: Congressional Budget Office, 2009.

Chairman NEAL. Thank you Mr. Burman.

Mr. Greenstein.

STATEMENT OF ROBERT GREENSTEIN, EXECUTIVE DIRECTOR, COMMITTEE ON BUDGET AND POLICY PRIORITIES

Mr. GREENSTEIN. Thank you very much.

Our team of budget experts at our Committee, led by three former senior CBO officials, has produced budget projections that indicate that if current policies remain unchanged, the debt will soar to about 300 percent of GDP by 2050.

To avert that problem and stabilize the debt at its current share of the economy would require about a 28 percent increase in taxes or a 22 percent reduction in expenditures for every federal program in the budget every year for the next 40 years between now and 2050.

The two main sources of rising federal expenditures over the long run, are, not surprisingly, rising costs throughout the whole U.S. health care system, public and private, and the aging of the population.

Those factors will drive up the costs of Medicare, Medicaid, and Social Security. And it is the growth and the cost of those three programs alone that accounts for all of the increase in non-interest spending as a share of GDP, over the next 40 years and as far as the eye can see.

In fact, total federal spending for all programs other than Medicare, Medicaid, and Social Security, including all entitlements other than those three, is projected to decline as a share of the economy, both in the coming decade and in the decades after that. That's not where the problem comes from.

It also should be noted that the 2001 and 2003 tax cuts are implicated here. If policy makers were to let those measures expire on schedule at the end of 2010, or to fully pay for them, that would shrink the fiscal gap between now and 2050 by about two-fifths.

Another way to look at it is that the cost of making permanent the tax cuts for people over $250,000 a year would itself cost as much over the next 75 years, or nearly as much over the next 75 years, as the entire 75-year Social Security shortfall.

Stated another way, if you think, correctly, that the Social Security shortfall is a contributor to the long-term fiscal problem, then if one makes the tax cuts for people over $250,000 permanent, one essentially doubles that in size.

So the bottom line is that we really need a balanced approach here, that includes a combination of sustained reform to the health care system, reductions in federal expenditures, and increase in federal revenues.

To be sure, the single most important step over the long term is slowing the growth of health care spending. The new legislation makes important first steps. Much more will need to be done over time, as we learn more how to do that.

But even with further major reforms in health care, it is likely to prove impossible to hold health care costs to their current share of the economy.

Older people have more health care costs than younger people, and the population's aging. And the primary cause of increase from year to year in health care costs, is advances in medical technology, and the country is not going to say, "We don't want the benefits of medical breakthroughs."

So an older society with more medical breakthroughs is inevitably going to spend more as a share of GDP on health care. And this means that the answer to the question of whether we can achieve fiscal sustainability wholly on the spending side is, as Len Burman also said, "No."

This leads to the conclusion that higher taxes along with reductions in projected spending, both need to be on the table, which in turn leads me to the conclusion that unlike the last round of major tax reform in 1986, coming tax reform efforts cannot be revenue-neutral. They need to make a contribution for long-term deficit reduction.

As Len noted, a key part of this needs to be looking at tax expenditures, or what Alan Greenspan, among others, has referred to as "tax entitlements."

People often talk of taxes and spending as though they're entirely separate parts of the budget. With tax expenditures now over a trillion dollars a year, roughly equal in cost to Medicare and Social Security combined, the distinction between taxes and spending becomes increasingly suspect. And as Len has noted, there's a lot of inefficiency in that part of the budget.

On the corporate side, we often hear it said correctly that the top marginal U.S. corporate income tax rate is above that of our competitors. But we don't hear as often, but it's right there in the 2007 Bush Treasury Department Study of Corporate Income Tax, is that the effective corporate tax rate in the United States is actually lower than the average for our competitors. We have a high rate and very narrow corporate tax base, which means that there should be room to reduce corporate preferences enough, both to reduce the top corporate rate, and to get a contribution to deficit reduction out of that reform.

Final point I'll make is many analysts and also the President have set an important goal of getting the deficit down to the point where the debt doesn't continue to rise as a share of the economy. Which means we've got to get the deficit down after the economy recovers to no more than 3 percent of GDP.

That will take a variety of actions. And the Congress faces key tests in the next several months that will have a heavy bearing on whether or not we can really get to 3 percent of GDP in the years ahead. Specifically it is critical to allow the tax cuts for high-income households to expire on schedule, and to hold the line on the 2009 estate tax parameters.

Extending the high income tax cuts, rather than allowing them to expire, would add $826 billion to the debt over the coming decade and more in decades after that. Weakening the estate tax would add tens of billions of dollars on top of that.

Now returning to the top marginal rates that we had in the Clinton years, when high-income people thrived, the economy boomed, small businesses created jobs at a faster rate than they did in this current decade, seems like an imminently sensible first step. And the bottom line, once again, is that the long-term fiscal challenge is so serious that everything needs to be on the table, both program expenditures and revenues.

[The prepared statement of Mr. Greenstein follows:]

Prepared Statement of Robert Greenstein
Executive Director Center on Budget and Policy Priorities

TESTIMONY OF ROBERT GREENSTEIN
Executive Director, Center on Budget and Policy Priorities

before the
Committee on Ways and Means
Subcommittee on Select Revenue Measures

March 23, 2010

I appreciate the invitation to appear before you today. I am Robert Greenstein, executive director of the Center on Budget and Policy Priorities, a nonprofit policy institute that conducts research and analysis on fiscal policy matters and an array of federal and state programs and policies.

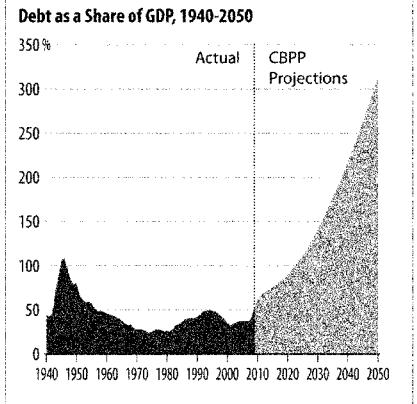
My testimony today makes three major points:

- While current budget deficits are not themselves a problem — large deficits are needed in a deep economic downturn such as this one — our current fiscal path is simply unsustainable over the longer term. Federal deficits and debt will rise to unprecedented and dangerous levels if current policies remain unchanged.

- Digging ourselves out of this predicament will require action on *both* sides of the budget — spending and revenues. We will not be able *either* to finance the kind of government that Americans want with revenues near their historical level of 18 to 19 percent of gross domestic product (GDP) *or* to leave current programs unchanged.

- Congress should try to get deficits down to about 3 percent of GDP by mid-decade. Deficits at that level would keep the debt from rising as a share of the economy and thus would go a long way toward reassuring our creditors and putting the budget on a more sustainable path. Congress will face some crucial decisions in the months ahead that will have a large bearing on its ability to attain this goal.

FIGURE 1
Debt Will Explode If Current Policies Are Continued



Source: CBPP projections based on CBO data.

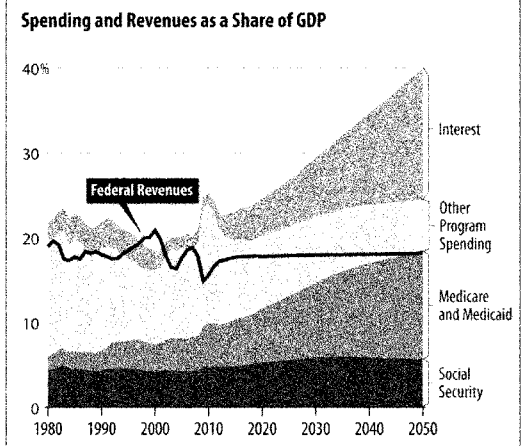
Current Budget Policies Are Unsustainable

We project that if current policies are continued without change, the federal debt will soar from 62 percent of the gross domestic product (GDP) today to about 300 percent of GDP in 2050. (See

Figure 1.) That would be almost three times the existing record (which was set when the debt reached 110 percent of GDP at the end of World War II) and would eventually threaten significant harm to the economy. Under this scenario, the annual budget deficit would exceed 20 percent of GDP by 2050.[1] (See Figure 2 and Appendix Table 1.)

Deficits and debt are projected to grow this much because expenditures — largely driven by rising health care costs — will grow much faster than revenues between now and 2050.[2] Under current policies, we project that program expenditures (i.e., outlays for everything other than interest payments on the national debt) will increase from 19.2 percent of GDP in 2008 to 24.5 percent in 2050. We project that revenues will be at 18.2 percent of GDP in 2050, which is a bit below their average of 18.4 percent of GDP over the 30 years through 2008. (I would note that the federal budget was balanced only four times in those 30 years, and in all four of those years, revenues stood at 20 percent to 21 percent of GDP.)

FIGURE 2
Deficits Will Soar As Spending Outstrips Revenues



Source: CBPP projections based on CBO data.

One way of expressing the long-run budget challenge in a nutshell is by focusing on the "fiscal gap"— defined here as the average amount of program reductions or revenue increases that would be needed every year over the next four decades to stabilize the debt at its 2010 level as a share of the economy. That gap equals 4.9 percent of projected GDP. To eliminate the gap would require a *28 percent* increase in tax revenues or a *22 percent* reduction in program (non-interest) expenditures over the entire 40-year period from now to 2050 (or, more realistically, a combination of tax increases and spending cuts).

[1] These estimates assume extension of the 2001 and 2003 tax cuts, extension of other expiring tax provisions (except for the explicitly temporary provisions of last year's recovery act), continuation of relief from the Alternative Minimum Tax (AMT), cancellation of the deep cuts scheduled under current law in fees paid by Medicare to physicians, and gradually diminishing funding for operations in Iraq and Afghanistan as we wind down our operations there. For more information, see Kathy Ruffing, Kris Cox, and James Horney, "The Right Target: Stabilize the Federal Debt," Center on Budget and Policy Priorities, January 12, 2010. These projections were done before CBO's latest round of revisions, but they would not change materially if updated.

[2] Automatic stabilizers — safety net programs whose outlays rise during recessions — along with temporary expenditures needed to stabilize the financial system and provide additional stimulus to the economy caused program expenditures to surge to 24.9 percent of GDP in 2009. Expenditures are projected to remain elevated for several years while the economy recovers and then to decline for awhile before starting a steady rise as health care costs continue growing faster than the economy and the population ages.

The two main sources of rising federal expenditures over the long run are rising per-person costs throughout the U.S. health care system (both public and private) and the aging of the population. Together, these factors will drive up spending for the "big three" domestic programs — Medicare, Medicaid, and Social Security. Growth in those programs accounts for *all* of the increase in non-interest spending as a share of GDP over the next 40 years and beyond.

Although demographic changes — the aging of our population — account for part of this increase, rising health care costs per person are by far the biggest single factor over the long term. For the past 30 years, costs per person throughout the health care system — in both government programs and private-sector health care — have been growing approximately two percentage points faster per year than per-capita GDP. Our baseline projections assume that this pattern will continue through 2050. Over time, the fiscal consequences of this rate of growth in health costs are huge.[3]

Last year's economic-recovery legislation is not responsible for the long-term fiscal problem; the recovery measures have added little to the long-term problem because they are temporary rather than ongoing.[4] Likewise, additional expenditures to support economic recovery of the magnitude that Congress is now considering would have only a tiny effect on the long-term picture.

Nor are federal spending programs *other than* the "big three" responsible for the long-term imbalance. Total spending for all federal programs other than Medicare, Medicaid, and Social Security is projected to *shrink* as a share of the economy in coming decades. These programs will consume a smaller share of the nation's resources in 2050 than they do today. In particular, aggregate spending for *entitlement* programs other than the "big three" (such as federal civilian and military pensions, food stamps, supplemental security income, veterans' benefits, family support payments, unemployment compensation, and the earned income tax credit) is expected to edge down as a share of GDP. These programs thus are not a cause of the long-term fiscal problem, and statements that we face a general "entitlement crisis" are incorrect.

In contrast, the 2001 and 2003 tax cuts are heavily implicated in our long-run fiscal problem. If policymakers were to allow these measures to expire on schedule at the end of 2010 — or to fully offset the cost of extending whatever portion of those tax cuts they chose to extend — that alone would shrink the fiscal gap by *almost two-fifths*, from 4.9 percent of GDP to 3.0 percent. Moreover, the cost of retaining and making permanent the tax cuts for people with incomes over $250,000 would be nearly as large over the next 75 years as the entire 75-year Social Security shortfall.[5] Let me hasten to add, however, that even if *all* of the 2001 and 2003 tax cuts were either allowed to expire or paid for, the budget would still be on an unsustainable long-term path.

---

[3] Rising costs throughout the health care system exacerbate the long-term budget problem in two ways. As is well known, they increase federal spending directly by raising the cost per beneficiary of providing health care through Medicare and Medicaid. Less well understood is that rising health costs worsen deficits even further by eroding the tax base. Because of tax preferences for employer-sponsored health coverage and certain other health care spending, when health care costs grow faster than the economy, the share of income that is exempt from taxation increases and the revenue base shrinks.

[4] See the box on page 6 of "The Right Target," cited in footnote 1.

[5] Kathy A. Ruffing and Paul N. Van de Water, "What the 2009 Trustees' Report Shows About Social Security," Center on Budget and Policy Priorities, May 18, 2009, p. 4.

Congress Needs to Tackle Both Spending and Revenues

The bottom line is that as the economy recovers, policymakers should begin to implement a balanced approach to addressing our long-term fiscal imbalance through a combination of sustained reforms of the U.S. health care system, reductions in federal expenditures, and increases in federal tax revenues.

The single most critical step is to slow the rate of growth in health-care spending. The health-care legislation that the House passed last weekend takes important first steps in that direction even as it expands coverage to an estimated 94 percent of those who reside legally in the United States. CBO judges that, in its second decade, the legislation (i.e., the combination of the Senate health bill and the new reconciliation bill) would reduce the deficit by about one-half percent of GDP — a significant amount. Over time, as we learn more about how to make health care delivery more efficient and to restrain health care cost growth without sacrificing health care quality, much more will need to be done.

Yet even if further major reforms are adopted, it is likely to prove impossible to hold health care expenditures to their current share of the economy. Older people have substantially higher health care costs than younger people do, and the population is aging. This means that expenditures for Medicare, Medicaid, and private-sector health care will necessarily rise even if the rate of growth in the cost of health care services is contained. In addition, although the U.S. health care system contains major inefficiencies that raise its costs, the *rate of growth* in those costs is largely fueled by advances in medical care and technology — and Americans almost certainly will want to take advantage of the medical breakthroughs that will occur in the decades ahead even if that progress carries a significant price tag. The historical record is clear that as people — and countries — grow more affluent, they tend to spend more of their incomes on health care in order to secure longer lives and better health that improves their quality of life.

Most experts consequently believe that although it will be possible — indeed will be absolutely essential — to reduce the rate of growth of per-capita health care costs to well below two percentage points per year faster than per-capita GDP, it is likely to prove impossible to slow growth so much that per-capita health care costs rise no faster than per-capita GDP. A society that both is older and has available to it the fruits of coming advances in medical technology will devote a bigger fraction of GDP to health care than we do today.

The Social Security challenge, by contrast, is manageable in size and straightforward to address through incremental, rather than fundamental, reforms. Social Security expenditures will grow substantially over the next two decades with the aging of the baby boomer population, but will then level off as demographic trends stabilize. Social Security costs are projected to be about one-fifth larger in 2050 than they are today, rising from 4.8 percent of GDP now to 6 percent of GDP in the mid-2030s and then subsiding slightly. Various government and non-governmental entities have laid out options for closing Social Security's financing gap with revenue increases, benefit reductions, or more likely, some blend of both.[6]

---

[6] See the Center for Retirement Research, *The Social Security Fix-It Book* (revised 2009 edition, online at www.bc.rrc.edu); National Academy of Social Insurance, *Fixing Social Security: Adequate Benefits, Adequate Financing* (October 2009, online at

In contrast, Medicare and Medicaid expenditures are projected to double as a share of GDP between now and 2035, and to continue rising inexorably even after that — not because of cost drivers peculiar to those programs but because of projected growth in health care costs systemwide. For more than 30 years the increase in costs per beneficiary in Medicare and Medicaid has mirrored the growth in costs per beneficiary in private-sector health care.

This means that the answer to the question of whether we can achieve fiscal sustainability wholly on the spending side is almost certainly "no." That cannot be done without shredding the social safety net and eviscerating critical services and investments. Indeed, a recent analysis by a National Academy of Sciences (NAS) panel presented four paths to budget sustainability. We do not concur with the panel's definition of sustainability; it aspires to a debt-to-GDP ratio of 60 percent (which implies deficits of about 2.3 percent of GDP), whereas we think that a 70 percent debt-to-GDP ratio (with deficits around 3 percent of GDP) is sustainable and much more realistic.[7] Nevertheless, the policies that the NAS panel outlined as part of the only one of its four illustrated paths that entails no revenue increases are striking. These policies include all of the following:

- Reducing the growth in costs per beneficiary in Medicare and Medicaid, beginning in 2012, all the way down to the rate of GDP growth. The panel noted this would entail going *well beyond* all of the measures that we know how to take to make health care more efficient. It thus would require cutting deeply into the basic health services that the programs provide to the elderly, the disabled, and the poor;

- Raising the Social Security retirement age *and* reducing the benefit formula for 70 percent of future retirees *and* trimming cost-of-living adjustments;

- Cutting all other spending — including defense, veterans, education, basic research, infrastructure, and assistance for people who are poor or vulnerable such as the frail elderly and people with severe disabilities — by 20 percent.

By enacting *all* of these policies, legislators could — in the NAS panel's estimate — keep revenues at their historical levels of between 18 and 19 percent of GDP. But enactment of all of these policies is unimaginable. It is not something Americans would accept. It would turn ours into a coarse society in which people who are not affluent are essentially "hung out to dry." Moreover, it likely would impair U.S. productivity growth over time as educational systems, infrastructure, and basic research suffered.

This leads to a basic conclusion that most experts have reached — namely, that higher taxes also must be on the table. As a result, unlike the last major round of tax reform in 1986, coming tax-reform efforts cannot be revenue-neutral. They must make a major contribution to long-term deficit reduction.

---

www.nasi.org); and the solvency options estimated by the Social Security Administration's Office of the Chief Actuary at http://www.ssa.gov/OACT/solvency/provisions/index.html.

[7] In fact, the NAS panel based its budget projections on CBO's March 2009 baseline. Because the budget outlook worsened as the year went on, the NAS paths almost certainly would no longer suffice to reach the panel's 60 percent target.

Tax Expenditures

As they did in 1986, lawmakers will need to take a hard look at tax expenditures, or what Alan Greenspan and other analysts have termed "tax entitlements."[8] The Joint Committee on Taxation (JCT) prepares annual estimates of tax expenditures costs, and by summing the JCT estimates over the years (an admittedly rough practice[9]) the Congressional Research Service found that tax expenditures rose from less than 6 percent of GDP in 1974 to nearly 10 percent in 1987. Under the Tax Reform Act of 1986, tax expenditures initially fell back to 5.4 percent of GDP, but have since crept back up to 7.6 percent of GDP in 2007. In many budget areas (such as housing), the cost of tax expenditures dwarfs the budget outlays devoted to the same purpose.[10]

Moreover, many tax expenditures provide subsidies to individuals or corporations and, as the term "tax expenditure" implies, are essentially government spending delivered through the tax code. Policymakers and pundits often talk of "taxes" and "spending" as though they were quite distinct categories of the budget. In fact, with the spread of tax expenditures — the cost of which now exceeds $1 trillion a year, roughly equal to Medicare and Social Security combined — the distinction between "taxes" and "spending" has become increasingly suspect and often obscures more than it illuminates. Tax expenditures are distinct from "spending programs" in one very problematic way, however — they generally receive significantly less scrutiny.

Adding to these concerns, most individual tax expenditures take the form of deductions or exclusions rather than credits. This means that they provide the largest subsidies to people in the highest tax brackets, despite the fact that those are the people who generally need the subsidies the least and for whom the effectiveness of a subsidy in inducing the desired taxpayer behavior consequently often is the weakest.

Consider, for example, the situation in which a teacher and a banker both seek to purchase a home and take out a mortgage. Through itemized deductions, the government will defray 15 percent of the teacher's mortgage interest costs and 35 percent of the banker's. Yet the size of the deduction is, if anything, more likely to affect the teacher's than the banker's ability to buy a home. This is why many tax policy experts from across the political spectrum believe the current deduction structure is economically inefficient (as well as complex). Indeed, President George W. Bush's Tax Reform Panel proposed turning the mortgage interest deduction into a uniform 15 percent tax credit.

---

[8] The Congressional Budget and Impoundment Control Act of 1974 officially defined tax expenditures as "those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability."

[9] See Leonard E. Burman, Christopher Geissler, and Eric J. Toder, "How Big Are Total Individual Income Tax Expenditures, and Who Benefits from Them?" American Economic Review, papers and proceedings, vol. 98, no. 2 (May 2008),.

[10] Thomas L. Hungerford, "Tax Expenditures: Trends and Critiques," Congressional Research Service, September 13, 2006; Thomas L. Hungerford, "Tax Expenditures and the Federal Budget," Congressional Research Service, February 27, 2009.

Initial Steps Related to Tax Expenditures

To begin to address these inefficiencies in the tax code and to make progress on the nation's fiscal problems, the President has proposed to limit the value of the deductions that individual taxpayers take to 28 percent (See Table 1). For the same-size mortgage, the banker referred to above would get a mortgage interest deduction worth about double the value of the deduction that the teacher could claim.

I support the President's proposal but recognize that it goes beyond what the political system will bear, at least at this time. But I recommend that Congress adopt an approach this year of holding deductions to their current 35 percent top rate. Given the inefficient design of deductions and the nation's alarming fiscal outlook, the value of deductions should not be increased to 39.6 percent for those in the top tax bracket when the top rate returns to 39.6 percent.

For more fundamental tax reform in this area in the years ahead, I urge policymakers to study an important paper co-authored in 2006 by Fred Goldberg, former IRS commissioner and Treasury Assistant Secretary under President George H.W. Bush, OMB Director Peter Orszag, and NYU tax law professor Lily Batchelder.[11] Their paper finds that in some crucial tax policy areas — such as providing incentives for retirement saving, college attendance, and the like — the current deduction structure is upside-down. The current structure loses massive amounts of revenue by over-subsidizing affluent individuals to take actions that, for the most part, they would have taken anyway, while providing too little financial incentive to change behavior among those who live paycheck to paycheck and for whom behavior-oriented tax incentives can have a larger effect. They recommend converting various deductions into flat-percentage refundable tax credits, in the interest of economic growth and efficiency, as well as of tax equity. As noted, some of the recommendations of President George W. Bush's tax reform panel charted a similar course.

Table 1: Obama FY2011 Budget Proposed Cuts in Tax Expenditures

Proposed Policy	10-year revenue raised (billions)
Limit the rate on itemized deductions to 28%	$291.2
Reinstate the limit on itemized deductions (Pease) for taxpayers with income over $250,000 (married) or $200,000 (single)	$155.3
Reform the US international tax system	$122.2
Set 20% rate on capital gains and dividends for taxpayers with income over $250,000 (married) or $200,000 (single)	$105.4
Repeal LIFO accounting methods	$59.0
Eliminate tax breaks for oil and gas companies	$38.8
Tax carried interest as ordinary income	$24.0

Source: Obama FY2011 Budget

[11] Lily L. Batchelder, Fred T. Goldberg, Jr., and Peter R. Orszag, "Reforming Tax Incentives into Uniform Refundable Tax Credits," Brookings Institution Policy Brief #156, August 2006.

Corporate Taxes

Inefficiency also is rampant on the corporate side of the tax code. The U.S. corporate income tax has a high marginal rate but raises only modest amounts of revenue because the *effective* corporate tax rate — the percentage of profits actually paid in taxes — is much lower. As the Bush Treasury Department put it in a study on competitiveness in 2007: "the contrast between [the] high statutory CIT rate and low average corporate tax rate implies a relatively narrow corporate tax base, due to accelerated depreciation allowances, corporate tax preferences, and tax-planning incentives…" [12]

Because the corporate tax base is so narrow, there is room to reduce corporate preferences sufficiently to *both* reduce the top corporate marginal rate *and* help curtail unsustainable budget deficits. Claims that no more can be collected in overall corporate tax revenues without impairing competitiveness are not sound. While the *marginal* rates that U.S. corporations face are out of line with the marginal rates in most other western industrialized nations, the average *effective* tax rates that U.S. corporations face are not. Appropriate corporate tax reforms can improve economic efficiency and competitiveness and raise revenues at the same time.

Given how dramatically U.S. multinationals have shifted their profits abroad, international tax issues should be a central component of tax reform. As Rosanne Altshuler from the Tax Policy Center and Martin Sullivan of *Tax Notes* have noted, in just about a decade the share of drug company profits taken abroad has increased from one-third to four-fifths.[13]

Congress Should Take Concrete Steps Soon

Over the coming decade, policymakers should aim to get the deficit down to about 3 percent of GDP and then to hold deficits at that level (or below). This will require actions much larger than the biggest deficit-reduction efforts of the past — the Tax Equity and Fiscal Responsibility Act of 1982, the reconciliation acts that followed the "budget summits" between the Administration and congressional leaders in 1987 and 1990, and the reconciliation act of 1993.

The largest of those actions trimmed deficits by about 2 percent of GDP. Over the 2013-2020 period, we will need savings about *one-and-a-half to two times as large*. Accomplishing this at the same time that the baby boom generation — the huge cohort born between 1946 and 1964 — begins to retire in large numbers, and without the "peace dividend" that permitted reductions in defense spending in the 1990s, will be a daunting task.

These actions will likely need to be taken over in several steps over a number of years. But Congress faces some key immediate tests in the months ahead. If Congress fails these tests, the mid- and long-term deficit and debt problems will be substantially worse, and the ultimate threat to the economy even more serious.

---

[12] US Department of the Treasury, "Treasury Conference on Business Taxation and Global Competitiveness: Background Paper," July 23, 2007.

[13] Martin A. Sullivan, "Economic Analysis: Drug Company Profits Shift Out of United States," *Tax Notes*, March 8, 2010; Rosanne Altshuler, "Where are the profits, and why?" *TaxVox Blog*, March 18, 2010, available at http://taxvox.taxpolicycenter.org/blog/_archives/2010/3/18/4483532.html

Specifically, Congress needs, at a minimum, to allow the tax cuts for high-income households to expire on schedule and to hold the line on the 2009 estate-tax parameters. Both of these are steps President Obama has proposed.

If Congress extends the high-income tax cuts rather than allowing them to expire, this will add $826 billion to the debt over the coming decade (including the increased interest payments that will have to be made), and add even more to deficits and debt in the decades after that because of the compounding effects.[14] Tens of billions of dollars in further deficits and debt will be run up if the estate tax is weakened further, for example by raising the estate-tax exemption to $5 million (effectively $10 million per couple) and reducing the top estate tax rate to 35 percent. Such changes would benefit the estates of only the wealthiest one-quarter of 1 percent of Americans who die; the estates of the other 99.75 percent are already exempt under the 2009 estate-tax parameters. These changes would shrink the average effective tax rate on the relatively few estates subject to the tax, which stands at 18.9 percent under the 2009 parameters, to 14.3 percent.[15] Changes in the estate tax such as these would represent a windfall for the biggest estates; estates worth over $20 million would receive additional tax cuts that average *$3.8 million per estate* if the exemption is raised to $5 million and the estate tax rate cut to 35 percent. Such measures are difficult to fathom at a time when the nation faces crushing long-term deficits.

In considering these matters, lawmakers also should take note of the fact that incomes have surged in recent decades for households at the top of the income scale while stagnating for ordinary Americans. High-income households benefited from very large tax cuts at the same time that they were capturing the lion's share of the increases in income that economic growth was generating.

During the most recent economic expansion (from the end of 2001 to the end of 2007), *two-thirds* of all of the gains in pre-tax income in the nation went to the *1 percent* of Americans with the highest incomes. These households received massive tax cuts at the same time.[16] Internal Revenue Service data show that between 1995 and 2007, the percentage of income that households with incomes over $1 million paid in federal income taxes fell by *nearly one-third*, from 31.4 percent of income to 22.1. The effective income tax rate of the 400 Americans with the highest incomes — those with adjusted gross incomes of at least *$139 million* in 2007 — fell even more. This group paid an average of 29.9 percent of its income in federal income taxes in 1995, but paid 16.6 percent in 2007.[17] Their effective tax rate was cut nearly in half.

---

[14] CBPP calculations of savings over 2011-2020 based on OMB estimates from February 2010 (http://www.whitehouse.gov/omb/budget/fy2011/assets/tables.pdf). President Obama's proposals to allow high-income tax cuts to expire include allowing the top two marginal tax rates to revert to 36 and 39.6 percent, the proposed reinstatement of Pease and PEP, and a 20 percent tax rate on capital gains and dividends for the specified income group.

[15] Estimates are for estates in 2011. See Tax Policy Center "Estate Tax Projections and Distribution Tables," http://www.taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=322&refTN=T09-0398.

[16] See Avi Feller and Chad Stone, "Top 1 Percent of Americans Reaped Two-Thirds of Income Gains in Last Economic Expansion," September 9, 2009, http://www.cbpp.org/files/9-9-09pov.pdf.

[17] See Avi Feller and Chuck Marr, "Tax Rate for Richest 400 Taxpayers Plummeted in Recent Decades, Even As Their Pre-Tax Incomes Skyrocketed," February 23, 2010, http://www.cbpp.org/files/2-23-10tax.pdf.

Given this context, returning to the top marginal rates that prevailed during the Clinton years — when high-income people thrived and the economy boomed — seems an eminently sensible first step in the face of the massive deficit and debt challenges we face.

The context regarding the estate tax is similar. Between 2001 and 2009, the amount of an estate's value that is exempt from the tax rose from $675,000 to $3.5 million per person, and the number of estates paying any tax shrunk from 1 in 50 to 1 in 500. Under the 2009 rules, a wealthy couple with two children can leave each of their children $3.5 million tax free (on top of giving $26,000 tax free to each child each year while the couple is still alive). This $3.5 million alone is more than a middle-class family making $70,000 a year earns during a lifetime, and the middle-class family pays taxes on that income every year. Simply making the 2009 estate-tax parameters permanent will itself cost $305 billion over the next ten years.[18]

Balanced Approach to Deficit Reduction is Needed

As policymakers begin to grapple with the need for substantial mid-term and long-term deficit reduction, everything should be on the table. Both measures related to program expenditures and measures related to taxes will have to be part of the solution.

I would note that some measures can simultaneously restrain expenditures *and* enhance revenues. Most experts believe that the CPI slightly overstates inflation. To address this overstatement, the Bureau of Labor Statistics has developed an alternative CPI. On average, the alternative measure, referred to as the chained CPI, rises about three-tenths of a percentage point more slowly per year than the traditional CPI. Congress could adopt use of the chained CPI on both the expenditure and revenue sides of the budget.[19]

Such a step would likely be attacked by some as cutting Social Security benefits or raising taxes, but such attacks would be unwarranted. The intention of the Social Security Act and the Internal Revenue Code is to adjust for inflation, not to *over*adjust. This reform would meet those intentions.

This change would produce small savings initially. But the savings would grow over time and become significantly larger in the years when the fiscal problems we face will be very serious.

Finally, it should be recognized that while the largest savings ultimately will need to come from slowing the growth in health care costs and hence in the costs of Medicare and Medicaid, there are practical limits to the amount of additional deficit reduction that can be achieved in the health care programs — and in Social Security as well — *over the coming decade.* Changes that affect these programs' beneficiaries will need to be phased in gradually in order to give people time to adjust. As an example, the increase in the Social Security retirement age enacted in 1983 did not start to take effect until 2000 and will not be fully phased in until 2022; this timetable has been crucial to public acceptance of the rise in the retirement age and to the lack of efforts to stop it from going into

---

[18] CBPP calculation based on CBO's March 2010 reestimate of the President's budget; includes $52 billion in interest costs from increased borrowing.

[19] See Congressional Budget Office, "Using a Different Measure of Inflation for Indexing Federal Programs and the Tax Code (February 24, 2010) and Center on Budget and Policy Priorities, "Case for a Social Security Cost-of-Living Adjustment in 2010 is Weak" (October 15, 2009).

effect. Second, the current health reform legislation includes most of the measures that mainstream experts have identified as steps we know how to take now to slow the growth in health care costs. It will take time for the important demonstration and research projects contained in the health reform bill to yield information on how to achieve the substantial additional savings we will need without sacrificing health care quality.

These realities mean that further substantial revenue increases — as well as savings in low-priority programs — will have to be on the table if we are to have any chance of shaving deficits to 3 percent of GDP over the coming decade. Health care and Social Security should be able to yield a larger share of the needed savings *over the long term* than they can provide *over the coming decade*.

This heightens the importance of policymakers not being swayed by the dubious arguments that letting the upper-income tax cuts expire (and preserving the 2009 estate-tax rules) would derail the economic recovery. In fact, any resulting drop in consumption by upper-income people would be modest, as research shows that a large share of the tax cuts that go to people at the top of the income scale are saved rather than quickly spent. This is why the Congressional Budget Office, in a recent report evaluating the impact of about a dozen options for boosting the economy and creating jobs over the next two years, rated extending the high-income tax cuts *dead last.*[20]

The economy would better be served by allowing these tax cuts to expire on schedule and using the proceeds for a short initial period to finance temporary policies that CBO and other experts have found would be more effective in boosting the economy and creating or preserving jobs. For example, additional funds to support state and local governments are badly needed to forestall unprecedented state and local budget cuts in the next year or two that would place a strong drag on the economy and could jeopardize the recovery. A continuation of extended unemployment benefits and other targeted, carefully designed measures for a temporary period also would boost aggregate demand and thereby help to preserve or create jobs. Shifting resources from high-income tax cuts to such measures would strengthen the economy and create jobs in the short run. Once the economy has recovered, however, all of the proceeds from letting the high-income tax cuts expire should go for deficit reduction.

[20] Congressional Budget Office, "Policies for Increasing Economic Growth and Employment in 2010 and 2011" (January 2010) and related testimony by CBO Director Douglas Elmendorf before the Joint Economic Committee (February 23, 2010).

APPENDIX TABLE 1

Budget Projections Show Deficits and Debt Growing Rapidly As a Share of GDP Through 2050

	Social Security	Medicare	Medicaid	Other Program Outlays	Total Program Outlays	Revenues	Interest payments on the debt	Surplus (+) or Deficits (-)	Debt Held by the Public (End of Year)
2000	4.2%	2.0%	1.2%	8.7%	16.1%	20.9%	2.3%	+2.4%	35%
2010	4.8%	3.1%	2.0%	14.1%	23.9%	15.6%	1.4%	-9.7%	62%
2020	5.3%	4.2%	2.1%	8.6%	20.2%	17.7%	4.4%	-6.9%	90%
2030	5.9%	6.2%	2.6%	7.8%	22.5%	18.0%	7.0%	-11.5%	141%
2040	5.9%	7.8%	3.3%	6.9%	23.8%	18.0%	10.8%	-16.6%	218%
2050	5.7%	8.9%	3.9%	6.0%	24.5%	18.2%	15.6%	-21.9%	314%

Source: CBPP calculations based on CBO data.

Chairman NEAL. Thank you, Mr. Greenstein.

Mr. Holtz-Eakin.

STATEMENT OF DOUGLAS HOLTZ-EAKIN, PRESIDENT, AMERICAN ACTION FORUM

Mr. HOLTZ-EAKIN. Chairman Neal, Ranking Member Tiberi, and Members of the Committee, thank you for the chance to appear today. I too have a written statement that I've submitted for the record, and look forward to the conversation.

I will make only a few points, much of which you've heard many times before, and even on this panel.

The first is that the fiscal outlook for the United States is, indeed, very bleak.

For quite some time, successive issues of the CBO's long-term budget outlook have painted the picture fairly clearly. Spending on Social Security will rise from about 4–1/2 percent of GDP now to about 7 percent due to the retirement of the baby boom. Spending on Medicare and Medicaid will rise similarly from 4–1/2 percent of GDP to under optimistic projections, 12 percent of GDP, under pessimistic even higher.

That means those three programs combined are about 20 percent of GDP, which is the traditional size of the Federal Government.

Layer on everything else that the government is expected to do, and you're looking at an increase somewhere in the vicinity of 30 percent.

It is not sensible to believe that you can grow your way out of such a problem. It is not sensible to believe that you can tax your way out of such a problem. Raising 30 percent of GDP in taxes on economic performance and leave behind a economy for our children that is badly impaired.

So the major innovation, if that's the right word, in recent times, has been that this bleak fiscal picture, which used to take two to three decades to evolve, has been compressed into a single decade.

If you look at the CBO's analysis of the President's budget proposals, they show deficits that never fall below $700 billion over the next decade. The deficit in 2020 would be $1.2 trillion, even after the economy is presumed to have fully recovered.

And this is a deficit picture that is driven by spending. In that budget projection, the revenues are 19.6 percent of GDP, well above the traditional levels in the United States. Spending is 25 percent of GDP, well above normal levels. Eliminating spending down to 20 percent of GDP would bring that budget into balance ten years out.

So in terms of the numbers, you can see quite clearly that the spending explosion is the source of the coming budget troubles.

I think it is very important to address this issue and address it quickly.

Number one, in the good news scenario, if we run deficits of this type, we will impair the ability to educate workers for the next generation; we will impair the ability to equip them with new technologies and the latest in the ability to raise their productivity. And we will condemn that generation to slower economic growth, slower rising wages, than they deserve. And we'll leave behind a tremendous debt on top of that.

It's fundamentally unfair to them.

In the bad-news version of this—the one that Len Burman is studying so carefully—we have a catastrophe. And the financial cri-

sis so devastates this economy that it makes the past several years look much less threatening than they felt to live through.

So I think this is imperative to get going on this, because it cannot just be a tax solution, and because these spending programs are hard to change. You need to start right now to get this problem under control.

Even if you are successful in doing all of that, I still think it's imperative for the members of this Committee in particular to look hard at the U.S. Tax Code, which simply requires an enormous amount of work at this point in time.

In my written testimony, I laid out my ideas for what I think the Tax Code is. I'm a big fan of consumption-based taxation.

I'll simply point out at the moment we have these very severe problems. The U.S. individual income tax has evolved over time into essentially a surtax on high-income Americans. It is no longer a broad-based revenue raiser. Almost a majority of Americans are excluded from the income tax at this point. And that income tax is poorly suited to the economic lives of the people who tax us. We spend an enormous amount of time trying to locate capital income somewhere on the globe, somewhere risk adjust it, get it at the right point in time and tax it. And we fail again and again and again.

The financial markets outwit us. I think we should develop a tax system that recognizes that reality, and eliminates from tax the return on capital income, but does it in a sensible fashion. And I outlined that in my testimony.

The second thing is that our corporation income tax really is placing us at a competitive disadvantage. Not only is the rate too high. We are the last country on the globe attempting to tax worldwide corporate income. We are literally swimming against the tide and losing jobs every day, as a result. It needs to be addressed and addressed quickly.

And lastly, for those individuals who are not affluent Americans, who are simply trying to get ahead, the kinds of refundable tax credits and other disguised spending programs in the Tax Code, as they are phased out, they are creating high effective marginal tax rates, tax rates that are higher on our modest Americans than they are on the top end.

And it's been increasingly difficult for people to get ahead. And I think we ought to look carefully at the incentive effects on lower-income Americans of the net effect of the income tax plus the phase-outs of refundable credits. It's a real impediment to their ability to get ahead.

I thank you for the chance to be here today, and I look forward to your questions.

[The prepared statement of Mr. Holtz-Eakin follows:]

Taxes and the Federal Budget

Testimony of:

Douglas Holtz-Eakin
President, American Action Forum*

United States House of Representatives
Committee on Ways and Means

March 23, 2010

*The views expressed here are strictly my own.

Chairman Neal, Ranking Member Tiberi, and distinguished Members of the Committee thank you for the privilege of appearing before the Committee today. The federal government faces daunting fiscal challenges, as the budgetary outlook is a threat to the very foundations of the U.S. economy and the tradition of leaving to the next generation a promise of prosperity that is greater then that which was inherited. In these circumstances, one can only hope that the business of this hearing would translate quickly into actual legislation, Congressional passage, and a reversal of the trajectory upon which federal government finds itself.

In my testimony, I hope to make three major points: (1) that the budgetary outlook is threat to the economic future of the United States, (2) that the budget outlook is driven by excessive spending, not a paucity of revenues, and (3) that the top tax priority should be reform, not revenue increases.

The Problem

The core, long-term issue has been outlined in successive versions of the Congressional Budget Office's *Long-Term Budget Outlook*. In broad terms, over the next 30 years, the inexorable dynamics of current law will raise federal outlays from about 20 percent of Gross Domestic Product (GDP) to anywhere from 30 to 40 percent of GDP. Any attempt to keep taxes at their post-war norm of 18 percent of GDP will generate an unmanageable federal debt spiral. In contrast, a strategy of ratcheting up taxes to match the federal spending appetite would be self-defeating and result in a crushing blow to economic growth.

The policy problem is that spending rises above any reasonable metric of taxation for the indefinite future. Period. There is a mini-industry devoted to producing alternative numerical estimates of this mismatch, but diagnosis of the basic problem is not complicated. The diagnosis leads as well to the prescription for action. Over the long-term, the budget problem is primarily a spending

problem and correcting it requires reductions in the growth of large mandatory spending programs and the appetite for federal outlays, in general.

Just as some would mistakenly believe that we can easily "tax our way out" of this budgetary box there is an equally misguided notion in other quarters that we can "grow our way out." The pace of spending growth simply must be reduced.

This depiction of the federal budgetary future has been unchanged for a decade or more. The diagnosis and prescription have remained unchanged. The only thing missing has been action; well, at least action in the right direction.

Those were the good old days. Now the problem is dramatically worse and happens more quickly. The federal government ran a 2009 deficit of $1.4 trillion – the highest since World War II – as spending reached nearly 25 percent of GDP and receipts fell below 15 percent of GDP. In each case, the results are unlike those experienced in over 50 years.

Going forward, there is no relief in sight. Each year the federal budget is projected to be in enormous deficit. Over the next 10 years, according to the CBO's preliminary analysis of the President's budget, the deficit will never fall below $700 billion dollars. In 2020, the deficit will be 5.6 percent of GDP, roughly $1.3 trillion, of which over $900 billion will be devoted to servicing debt on previous borrowing.

The budget outlook is not starved of revenues. The CBO projects that over the next decade the economy will fully recover and revenues will be 19.6 percent of GDP – over $300 billion more than the historic norm. Instead, the problem is that spending. Federal outlays in 2020 are expected to be 25.2 percent of GDP – about $1.2 trillion higher than the 20 percent that has been business as usual in the postwar era.

As a result of the spending binge, in 2020 debt in the hands of the public will have more than doubled from its 2008 level to 90 percent of GDP and will be on an upward trajectory. Measured in nominal dollars, by 2008 our Republic had amassed a debt of $5.8 trillion. The debt is expected to relentlessly expand. In 10 years, it will be $20.3 trillion – nearly $60,000 per American.

In short, what used to be a problem that would take 30 years to mature is now upon us in the next decade. The diagnosis is the same – too much spending and too much debt – and the prescription is the same. But there is less time to waste.

The Risks

Deficits have economic consequences that impact both fairness and growth. At the most basic level, they force our children and grandchildren to pay the bill for our over-consumption. Often it is argued that it is "fair" to do so because the debt-financed spending confers a corresponding benefit to those generations, but the debts contemplated in the near future cannot pass any reasonable test of equity.

Federal deficits can crowd out domestic investment in physical capital, human capital, and technologies that increase potential GDP and the standard of living. Financing deficits may require net capital inflows that crowd out exports and harm our international competitiveness. We should worry about large borrowing from competitors like China limiting the United States' range of economic and diplomatic options.

In addition to these continued, corrosive effects of budget deficits, analysts have long worried about more dramatic fallout from the budgetary outlook. At what point do rating agencies downgrade the United States? When do lenders price additional risk and charge higher interest rates to federal borrowing, leading to a damaging spike in interest rates? How quickly will international investors flee the dollar for a new reserve currency? If so, how will the resulting

higher interest rates, diminished dollar, higher inflation, and economic distress manifest itself? How quickly could such a tsunami of debt-related economic weakness arise? And when could it happen?

Since the basic outlook has been around for a quite some time, one explanation of why such events have yet to transpire is that the same financial market analysts who understand the weak state of the U.S. books also believe that they will be rectified before serious distress arrives. That is, they are counting on the U.S. to put its house in order.

If so, the marked deterioration in the next 10 years raises the urgency of action. Put bluntly, the U.S. is relying on the faith of others in its ability to undertake serious budgetary reforms, and time is getting short.

The obvious problem is that movement in the other direction is hard – lower spending – and requires sacrifice. Will it be worth it? There is no way to know for certain. However, if Congress *does* take action and it turns out that there was never a risk of being punished by international capital markets or otherwise suffering economic disruption, then all that will happen is that national saving will be higher, productivity and wages will grow, international competitiveness will be enhanced, and the federal budget will have maneuvering room in the event of a future crisis. If, on the other hand, it *does not* and these threats are real the Nation will be demonstrably weakened.

In thinking about these risks, it is useful to note that we are in an era unlike the past. While there have been nations whose debt approached or exceeded U.S. levels, it has never been in a situation in which nearly every part of the developed world faces a debt problem comparable (or worse) to that of the United States. We simply have no experience with massive debt management on this global scale, raising the risks associated with inaction.

The Need to Control Spending

This hearing is intended to discuss the tax code, the central purpose of which is to raise revenue to finance federal outlays. As noted above, in the years to come mandatory spending programs will grow quite rapidly. The rising fiscal pressures emanating from spending on Social Security and health programs, if left unchecked, will threaten the three pillars of U.S. post-war economic success. First, the successful U.S. economic strategy has been to rely largely on the private sector; the mirror image of this approach being a government sector that is relatively small (granted, "small" is in the eye of the beholder) and contained. Growth in spending of the magnitude promised by current laws guarantees a much larger government.

Second, the small U.S. government has been financed by taxes that are relatively low by international standards and interfere relatively little with economic performance. Spending increases of the type currently projected would entail taxes higher by 50 percent or more to unprecedented levels. Such a policy would impair economic growth and reduce living standards for future generations.

Finally, a hallmark of the U.S. economy has been its ability to flexibly respond to new demands and disruptive shocks. In an environment where old-age programs consume nearly every budget dollar, to address other policy goals future politicians may resort to mandates, regulations, and the type of economic handcuffs that guarantee lost flexibility.

In sum, the ability of the tax code to meet its primary objective is most threatened by the absence of reforms to mandatory spending programs. This raises the specter of a generational injustice: bequeathing to our children and grandchildren a rising burden of taxation, a less robust economy, or both. The most pressing issue of fairness cannot be addressed by raising taxes, but rather requires a reducing the growth of spending.

The Need For Tax Reform

As noted above, the central budgetary challenge is to control the rise in federal spending. However, even assuming that Congress rises to this challenge, it will be desirable to undertake reforms of the federal revenue system.

1. Objectives of Tax Policy

Keeping the burden of taxes low. The importance of keeping federal spending contained to national priorities and thus permitting taxes to be as low as possible is straightforward: taxes directly reduce the ability of families to pay their bills and save for the future. However, even the best tax system impairs market incentives, imposes obstacles for households and firms alike, and undermines economic performance. A goal of tax policy should be to keep such interference and waste a small as possible.[1]

In this regard, unfortunately, our tax code is in need of a major overhaul. Tax-based distortions permeate our daily economic lives. Decisions on saving, retirement, education, investment, debt and equity finance are driven by tax-based planning to the detriment of our ability to meet pressing national needs. The tax code is a basic impediment to the United States' ability to grow robustly and compete on global markets.

The loss in economic performance is exacerbated by the sheer cost of complying with an overly complex tax code. According to the recent President's Advisory Panel on Federal Tax Reform, "If the money spent every year on tax preparation and compliance was collected – about $140 billion each year or over $1,000 per family – it could fund a substantial part of the federal government, including the Department of Homeland Security, the Department of State, NASA, the Department of Housing and Urban Development, the Environmental

[1] This loss is sometimes referred to as the "efficiency cost," "deadweight loss," or "excess burden" of the tax system and captures the reality that there is a loss to households above and beyond the amount of tax revenue collected.

Protection Agency, the Department of Transportation, the United States Congress, our federal courts, and all of the federal government's foreign aid."[2]

Supporting economic mobility. The tax code should not unnecessarily impair the ability of lower-income families lacking insurance to climb up the ladder of American prosperity.[3] Recent legislative efforts such as the stimulus bill and the Senate health care bill raise to shocking levels the effective marginal tax rates (EMTR) on lower and middle-income singles and families –with the government taking up to 41 percent of each additional dollar.

The effective marginal tax rate is the answer to the question: "If I earn $1 more, how much less than $1 do I get to save or spend?" If you can keep that full dollar for your disposal, the effective marginal tax rate is zero. If earning another dollar does not raise your disposable income by even a penny, the effective marginal tax rate is 100 percent.

Obviously, neither extreme is realistic. But exactly where federal policies come down in between has dramatic implications for the ability of families to rise from the ranks of the poor, or to ascend toward the upper end of the middle class. This mobility is the heart of the American dream that has made the United States a beacon of economic light for centuries.

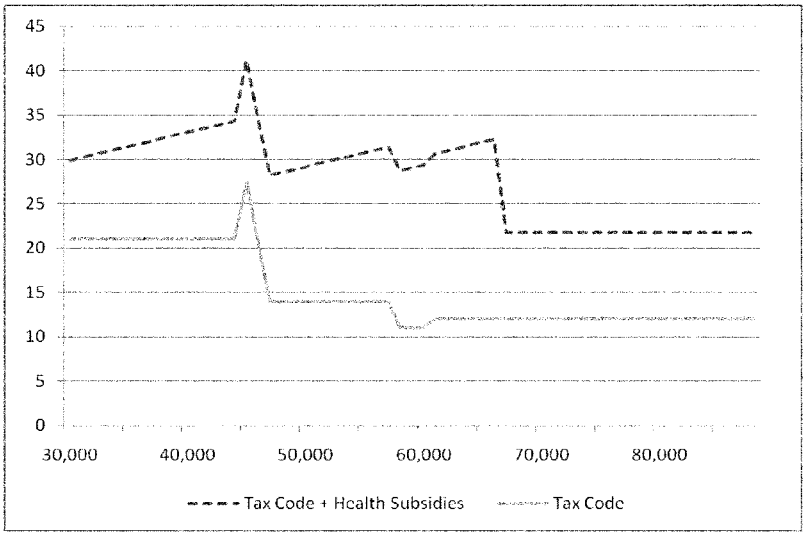
Consider, then, the figure below constructed for a two-earner family with two school-age children, one of whom is in college. The solid line shows the EMTR based on income tax law prior to the health care bill (it excludes the impact of the payroll taxes). The dashed line displays the damaging increases in the EMTR assuming the health insurance premium subsidies contained in the Senate health

[2] See the final report at http://www.taxpolicycenter.org/taxtopics/upload/Tax-Panel-2.pdf

[3] This section draws on my joint work with Alex Brill. See http://online.wsj.com/article/SB10001424052748704259304575043302815479426.html

care bill and insurance cost estimates provided by the Kaiser Family Foundation. As a family's income rises above 133 percent of poverty, Medicaid eligibility will be eliminated but a family that does not receive health insurance from their employer will receive a subsidy to purchase health insurance in the "exchange." In turn, however, as their efforts yield higher income, subsidies are clawed back or effectively taxed away.

The current law policies show that there are already some lower income families facing EMTRs above those in the middle class. But the barrier to success imposed by health care reform is even more striking. According to the Congressional Budget Office, about 20 million people would receive a subsidy to purchase insurance through an exchange and thus face a higher EMTR.



How can a family be expected to get ahead when taking an extra shift, finding a way for a second parent to work, or investing in night school courses to qualify for a raise means handing the government as much as 41 percent of the additional income earned? Parents already juggle the tough trade-off between

working more to build their family's future and spending time at home with their children. The bigger the EMTR, the tougher that tradeoff becomes.

Every "phase-out" of a tax credit or subsidy program is an EMTR in disguise. The cumulative impact is a cruel twist on "targeting," as families are anchored near the bottom of the income distribution by layers of fiscal cement. Excessive EMTRs damage these incentives, discourage the taxed, and threaten to rob America of a vitality that is its signature.

Fairness. A final objective is to raise taxes in a fair fashion. Unfortunately, there are two major obstacles to an easy evaluation of the success in meeting this standard. The first is figuring out who really pays a tax.[4] For example, in 2012 the CBO projects that the federal government will raise over $300 billion from the corporation income tax. However, corporations will not "pay" the tax in any meaningful sense – they merely send in the check. In the process of meeting their tax obligation, however, firms could raise prices, cut back on wages, reduce fringe benefits, slow replacement of equipment or scale back expansion plans, cut dividends, or many combinations of their options to alter their revenues and cost structures. The result is that the corporation tax is "paid" by customers, workers, or investors. Indeed, recent evidence suggests that the relatively high U.S. corporation income is ultimately paid by workers in the form of lower wages.[5]

A second difficulty is the absence of an ethical consensus on distributional fairness. In the absence of such benchmark, two guidelines prove useful. The first is to note that individuals view market transactions as a "fair deal" when they get back value equal to what they paid. By analogy, a benchmark for judging the tax system is whether a taxpayer's liability is equal to benefits received from the federal budget – a neutral system. If benefits received exceed taxes, the household is a net beneficiary of the tax system and *vice versa*.

---

[4] This is referred to as determining the economic incidence of a tax.

[5] See Kevin Hassett and Aparna Mathur, "Taxes and Wages," AEI Working Paper #128, 2006.

This perspective differs from two other metrics that are commonly employed – effective tax rates and tax shares. Effective tax rates are the ratio of taxes paid to income – roughly the share of income taken by taxes. A drawback to evaluating fairness using effective tax rates is that the rates may change because of movements in the denominator – families' incomes – that have nothing to do with tax policy. Incomes are influenced by taxes, but also are determined by skills, education, effort, risk-taking and innovation, regulations, and other factors. Tax shares – the fraction of the overall taxes that each individual pays – have the drawback that they ignore the spending side of the equation. Given that taxes are necessary only because of spending, this omission is striking.

Viewed from this perspective, the U.S. tax code is highly progressive – lower income individuals receive much more than they pay in taxes. According to the CBO, over the bottom 40 percent of the income distribution paid no federal income tax in 2006.[6] Of course there are other taxes. In particular, payroll taxes are the largest tax for a majority of households. But examining the payroll tax is ultimately a reminder of the need for social security reform. The progressivity of this programs will depend upon the scale of the benefits individuals receive in the future.

A second perspective on fairness stems from the fact that the tax code assigns taxpayers with the same income, number of children, and other factors different tax burdens. As noted above, taxes will differ depending on whether a family purchases health insurance or receives it as part of an employer compensation package. Two families with the same income will pay different taxes because they reside in different states, and some families receive state-provided services for which they can deduct income and property taxes. A person who saves more of their earnings in taxable accounts will pay more in taxes than a non-saver who has the exact same earnings year by year. Indeed, some inequality may stem

[6] See Congressional Budget Office, *Historical Effective Tax Rates: 1979 to 2006*, April 2009.

from the sheer complexity of the tax code and the inability of individuals to take advantage of tax benefits for which they are eligible. These differences between otherwise similar taxpayers are at odds with basic fairness and undermine faith in the fairness of the tax code.

Summary. The most pressing tax fairness issue facing the United States is the potential for dramatic tax increases, slower income growth, and reduced standards of living for future generations if the spending growth profile of the federal government is not reduced. All other fairness issues pale by comparison.

As the economy recovers, the federal tax system will roughly achieving its goal of providing financing for federal spending. However, there is little else to defend in the current tax code. It is overly complex and burdensome, interferes too much with commerce and economic competitiveness, and is riddled with uneven treatment. Far-reaching reforms are merited; more modest efforts will not succeed in raising federal revenues in a pro-growth and fair fashion.

2. Objectives for Tax Reform

Consumption-based taxation.[7] A consumption tax is just what it sounds like: a tax applied to consumption spending. However, under that deceptively simple umbrella resides a vast array of potential variants. Consumption taxes can be flat or contain multiple rates; can be applied to households, firms, or both; and can be viewed as "direct" or "indirect" taxes.

For purposes of my remarks today, let me focus on a few identities that give the flavor of the issues. For a household – or the country as a whole – all income (Y) is either consumed (C) or saved (S): Y=C+S. This suggests two broad strategies for taxing consumption. One is to tax consumption (C) as in a national

[7]This section draws on Douglas Holtz-Eakin, "The Case for a Consumption Tax," *Tax Notes*, October 23, 2006.

sales tax. The alternative is to tax it "indirectly" by levying the tax on "consumed income" – income after deducting saving or investment: (Y-S). This is the strategy taken by a value-added tax (VAT), the Hall-Rabushka flat tax, or the "X-tax", a more progressive variant of the Hall-Rabushka tax developed by the late David Bradford.

Interest in a U.S. consumption tax is not new. Advocates have touted the potential benefits from moving to a consumption tax for many years. However, I wish to separate my support from some of the more overreaching arguments. In particular, my support for a consumption-based tax reform is not about:

1. Simplicity. Some consumption taxes – notably the original Hall-Rabushka flat tax – have been publicized on the basis of their "simplicity." Who can forget (admittedly tax economists have a limited reservoir of thrills) the first time they saw the Hall-Rabushka postcard tax return? Similar simplicity arguments have been made about a national retail sales tax, where advocates tend to argue that there is little to do except piggyback on existing state efforts.

But this really misses the point for three reasons. First, no tax system will be that simple. For any household, the goal is to legally minimize its tax liability. The innate craftiness of the American populace will dictate that any tax system will acquire a growth of rulemaking that delimits the boundaries of acceptable behavior. That is, a certain amount of complex rule-making will be necessary. A common complaint of income-tax defenders is that consumption tax folks compare an ideal consumption tax with the actual income tax. This is truly unfair and no way to decide between the two. Second, as noted above, for many there is nothing simpler than the current income tax – they don't pay it. As is becoming more widely appreciated, the current income tax is not your father's income tax. Complexity of the income tax is the curse of those who pay it. Third, postcards are obsolete. Today your taxes are "done" – that is computed – by tax-preparation software and filed on-line.

2. Making taxes more or less visible. A common argument supporting a national sales tax is that it would make more visible the cost of government. Perhaps, but the ultimate measure of the size of government is its spending. Once the dollars have been committed, the taxpayer will pay one way or the other. Either taxes will be levied to match the spending, or there will be borrowing to cover the federal deficit. It may be important to raise the visibility of Congressional decisions, but putting taxes on your register receipt does not display spending. Indeed, if a national sales tax did produce pressure to keep taxes low, it may do nothing to address the tsunami of future Medicare spending and lead to larger deficits.

3. Raising the national saving rate. A consumption tax would remove the tax-bias in favor of current consumption, and many believe that this would raise the private saving rate. If so, then good. The main idea is to eliminate tax-based financial decisions and have households choose based more on the economic fundamentals. However, I suspect that the scope for dramatic changes is a somewhat limited. Instead, the most rapid improvement in the national saving rate will come from controlling federal spending and thus reducing government borrowing.

Instead, a consumption tax meets the following needs of the tax system:

1. The philosophical foundation of the tax code. Public policies should mean something. As I have stressed, the tax code exists for a single purpose: it exists to finance the costs of public programs. The powerful behavioral effects of taxation are real, and a tribute to the power of market incentives as the mechanism by which taxes influence behavior is to is change prices. Since the purpose of the tax code is to raise revenue, it has as its core mission the reducing the resources of some households. The central question is why choose those who consume over those with income. Consumption is the spending that extracts resources from the economy. In contrast, saving is economic activity necessary to contribute to a growing economy. Recall the identity: Y=C+S. An income tax treats identically

those high-income individuals who live frugally and plow their resources back into the economy and those that spend every night drinking champagne in a limousine while hopping from club to club. Taxing consumption reduces the burden on the former, while focusing it on the latter.

2. Economic efficiency. A consumption tax would reduce the extent to which economic activity is dictated strictly by reducing taxes (an unproductive use of time and money). First, it broadens the tax base to include all consumption. The essential recipe in any tax reform is to broaden the tax base and lower tax rates. Specifically, the base would include the consumption of employer-provided health insurance (currently entirely untaxed) thereby correcting a major inefficiency that feeds health spending pressures. In addition, it would eliminate the current deduction for state and local taxes, thereby including consumption provided by sub-federal governments. Thus, it would improve the allocation of consumption spending across sectors.

A consumption tax would not distort household choices in the timing of consumption – after all you would either pay the tax now or pay it later. In contrast, under an income tax households pay at both times if they choose to save and consume later. A consumption tax would equalize the tax treatment of investments in physical capital, human capital, and intangible capital. At present, the firm purchases of the latter two types of investment are "expensed" (immediately deducted), while physical capital expenditures are depreciated. Moreover, by eliminating the deduction for mortgage interest, the allocation of physical capital would be improved as business investments would compete on a level playing field with the construction of housing.

A desirable feature that is difficult to quantify is the impact on entrepreneurs. Entrepreneurial forces are widely acknowledged to be important to the success of the United States, but tax policy is rarely formulated with an eye to their incentives. For example, entrepreneurial ventures develop a scale and financial structure dictated by market conditions. In contrast, the tax code interferes with

these incentives – extracting a double tax on equity in "C corporations", subsidizing leverage, and thus distorting the choices of business form and financing. The flat business-level tax does not depend on financial structure – it is focused on "real" business transactions – and yields the same liability regardless of legal organization.

3. Acknowledgment of reality. Our current income tax is an exercise in fantasy. An important part of its administration is the taxation of the return to capital. To be successful, this requires that capital income – interest, dividends, capital gains, rents, royalties – be comprehensively measured and adjusted for depreciation and inflation. There is no reason to believe that the U.S. is even moderately successful in this effort, or that the continuing maturation of global financial markets will make it anything but less successful in the future. A consumption tax focuses the tax base on real economic activity – not financial transactions. This is an important difference in a world in which global financial markets have made if virtually impossible to tax capital income, and an excessive regulatory and enforcement regime has grown up around attempts to do so. Instead, the consumption tax focuses on "taxing at the source" before business income enters into financial markets and ultimately is paid to investors.

Specifically, the X-tax (along with the VAT or flat tax) would impose a single-rate business-level tax on a base that consisted of total receipts minus the sum of purchases from other firms and employee compensation. Implicit in those receipts is the contribution of capital, which is taxed prior to distributions in the form of dividends or interest.

4. Fairness. Because a consumption tax is neutral regarding the timing of consumption, it does not penalize those patient households that save their income for a greater lifestyle later in life. That is, two households with the same lifetime income will pay the same lifetime taxes. More generally, consumption taxes may be designed to achieve conventional distributional goals. To begin, under the X-tax, households are taxed on the basis of comprehensive employee

compensation. However, such a system would include a generous exemption for a basic standard of consumption and a progressive rate structure.

A concern often raised is that taxing compensation permits high-income individuals to "avoid" tax on their capital income. However, an appropriately-designed consumption tax includes the vast majority of such earnings in its base. In the X-tax, saving and investment is immediately tax-deductible or expensed, but all principle and interest is taxed in the form of revenues at the entity level. Mechanically, this differs from an income tax only by the fact that under an income tax the saving and investment would be depreciated and not expensed. That is, the two approaches differ only by the timing of tax receipts to the U.S. Treasury – less up front for the consumption tax because of expensing, but more in later years because there is no ongoing stream of depreciation. Accordingly, the two tax bases differ only by the return to Treasury securities – the least risky and lowest rate of return. All additional returns – accruing from risk, monopoly power, luck, and other sources – are included in the tax base of both tax systems. Since these types of capital returns are responsible for the largest differences in incomes and consumption tax would capture these in the base, the distributional consequences of such a consumption tax would be in accord with U.S. tradition.

Tax policy and the distribution of economic well-being. Concern has arisen that economic growth no longer translates into acceptable increases in standards of living for too many American households. This has generated a further concern that pro-growth tax policy *per se* is responsible. The facts, however, suggest otherwise. The dominant source of change in the income distribution is a long-term trend in the wage structure in the U.S., and not recent changes in tax policy. To the extent that policymakers wish to address this issue, the most fruitful approaches involve improving K-12 educational outcomes, thereby equipping future workers with better skills and the ability to be successful in college.

A large literature in labor economics documents a substantial widening of the U.S. wage structure during the 1980s.[8] Wage differentials by education, by occupation, and by age and experience group all rose substantially. The growth of wage inequality was reinforced by changes in non-wage compensation leading to a large increase in total compensation inequality. These wage structure changes translated into a rise in household income inequality. The trend to wage inequality in the 1990s was considerably slower than in the 1980s, with the key feature being that the highest earners (the 90th percentile of the wage and earnings distribution) continuing to grow faster than the median, but no noticeable decline for low earners. The more recent labor market data suggests a continuation of this pattern.[9]

Thank you for the opportunity to appear today and I look forward to answering your questions.

---

[8] See, for example, Attanasio, Orazio and Steven J. Davis. 1996. "Relative Wage Movements and the Distribution of Consumption." Journal of Political Economy 104 (December): 1227-62;,Autor, David H., Lawrence F. Katz, and Melissa S. Kearney. 2005. "Trends in U.S. Wage Inequality: Re-assessing the Revisionists." NBER Working Paper 11627, September; Autor, David H., Frank Levy, and Richard J. Murnane. 2003. "The Skill Content of Recent Technological Change: An Empirical Investigation." Quarterly Journal of Economics 118 (November): 1279-1333; Cutler, David M. and Lawrence F. Katz. 1991. "Macroeconomic Performance and the Disadvantaged." Brookings Papers on Economic Activity, 1991:2, 1-74; Cutler, David M. and Lawrence F. Katz. 1992. "Rising Inequality? Changes in the Distribution of Income and Consumption in the 1980s." American Economic Review 82 (May): 546-51; Goos, Maarten and Alan Manning. 2003. "Lousy and Lovely Jobs: The Rising Polarization of Work in Britain." Unpublished paper, Center for Economic Performance, London School of Economics, September; Hamermesh, Daniel S. 1999. "Changing Inequality in Markets for Workplace Amenities."Quarterly Journal of Economics, 114(4), November, 1085 – 1123; Karoly, Lynn and Gary Burtless. 1995. "Demographic Change, Rising Earnings Inequality, and the Distribution of Well-Being, 1959-1989." Demography 32: 379-405; and Piketty, Thomas and Emmanuel Saez. 2003. "Income Inequality in the United States, 1913-1998." Quarterly Journal of Economics 118 (February), 1 – 39.

[9] Another set of concerns relates to inadequacies in the measurement of earnings, income, and standards of living more generally. For example, (1) real wages have grown more slowly than real compensation because benefits are a rising portion of total compensation; (2) standard price indexes overstate inflation, causing an understatement of real compensation gains; and (3) traditional poverty measures failure to adequately reflect redistributive taxes and transfers.

Chairman NEAL. Thank you very much, Mr. Holtz-Eakin.

Mr. Barthold, we've heard a lot of testimony today about greater scrutiny for tax expenditures. And obviously Joint Tax would be the first place that we would turn for assistance on this regard.

Can you tell me what the Committee currently at Joint Tax may be doing in this regard?

Mr. BARTHOLD. Yes, Mr. Neal. One standard thing that we do annually is prepare for the Budget Committees and for the Ways and Means Committee and the Finance Committee a list of tax expenditure provisions and our estimates of tax expenditures. I should note, the tax expenditure estimates are not the same as revenue estimates—but it shows more the scale of activity that is encompassed by the tax expenditure.

We also stand ready to work with any member who wants to investigate any particular provision. And we are also doing some work on our own in light of the House of Representatives directive in the extender legislation that the House passed that would have directed us by statute to undertake a formal study.

We have begun to try and put together a study and make a plan to study some of the provisions that were identified in that legislation, notwithstanding that that legislation has not become law, but because the members were interested.

Chairman NEAL. And Professor Burman, one of your charts references the post-war average of tax revenues at 18.3 percent of GDP. Mr. Holtz-Eakin has told us that attempts to keep taxes at this ratio will generate, as he says, "an unmanageable federal debt spiral."

However, other conservatives are warning that we must be mindful of this ratio. How does this compare to other similar economies, and how should we manage it, in your judgment, going forward?

Mr. BURMAN. Our taxes are still low, relative to virtually all the other OECD countries. I think Japan has a lower tax burden than we do. The highest overall tax burden, the last time OECD compiled them, was 48 percent for Denmark.

Now our total tax burden is higher than 18 or in the 20 percent it was before the recession; because we also collect a fair amount of taxes at the state level as well. But overall, the total taxes are about 30, 35 percent of GDP.

So there is some scope before we would be competing for the top of the tax competition.

But I should also point out that, you know, we're not Denmark. I don't think it would be possible for us to raise taxes at 48 percent of GDP. But our taxes are low, by comparison.

Chairman NEAL. All right.

And Mr. Holtz-Eakin, am I correct that it was during your tenure at CBO that you studied the impact on that economy of an across-the-board tax cut to determine whether in fact this popular tax cut would "pay for itself?" Can you tell us today whether you agree with this assertion that tax cuts pay for themselves? And you know I wasn't letting you out of the room without raising that question, would you?

[Laughter.]

Mr. HOLTZ-EAKIN. I'm shocked. No. I've never believed that tax cuts pay for themselves, as a generic statement. That's not a sensible way to think about it.

You need to decide what you're going to spend in a disciplined fashion, and taxes exist to finance those expenditures.

Chairman NEAL. I appreciate that answer, largely because, you know, we went back and forth on this at Budget some years ago. And your position has been consistent on it. And I'm indeed appreciative of that.

Mr. Greenstein, I was a little bit confused by something in your testimony, where you compare the long-term cost of extending the 2001 and 2003 tax cuts for the wealthiest taxpayers with the cost to cover the entire Social Security shortfall over 75 years.

Would you break down that comparison?

Mr. GREENSTEIN. Yes. This comparison sometimes surprises people, because they're used to estimates for tax cuts just for the first ten years, and we're used to Social Security estimates over 75 years. Well, you obviously can't compare a ten-year-cost of one item to a 75-year-cost of another item.

The estimates from the Treasury that are in the President's budget show that the cost were we to continue the tax cuts for people over $250,000 a year that the President has proposed be allowed to expire. If one were to continue those, the Treasury estimate is that the cost is about 1/2 of 1 percent of GDP.

Most revenue estimates, when CBO does its long-term estimates, generally the estimates are that once you have a set of policies in place in the Tax Code, that the amount of revenue that they bring in tends to stay constant over time as a share of GDP, unless you change them.

So following the standard methods, the estimate here would be that if these tax cuts when fully in effect over the coming decade, if they stayed in effect, were 1/2 of a percent of GDP, their cost over 75 years would be expected to be about half of a percent of GDP.

Now the CBO estimate of the size of the 75-year Social Security surplus is also a half a percent of GDP. The Social Security actuary's estimate, which we tend to rely on a little bit more, is 7/10 of a percent of GDP.

So we're somewhere in the half to 7/10 of a percent of GDP cost for the imbalance in Social Security over 75 years, and were we to make the tax cuts permanent for people over $250,000, that's half a percentage point of GDP.

So the two are roughly the same in their cost over time. As long as you compare apples to apples, in other words, the same periods of time, the costs are comparable.

Chairman NEAL. Thank you.

And Mr. Barthold, I know you have a chart showing how the extension of the 2001 and 2003 tax cuts will impact those families hit by AMT. Can you tell us how many families will be on the AMT by 2020 if we do not extend the AMT patch, and how many filers is that to the total number of filers?

Mr. BARTHOLD. Yes, Mr. Chairman. In 2020, our current projections for individual tax filers is that there'll be approximately 146.5 million filers in 2020. And we estimate that without change,

that the AMT would affect approximately 50 million or slightly over a third of the universe of individual tax filers in 2020.

Chairman NEAL. Mm-hmm. Thank you, Mr. Barthold.

Now I'd like to recognize Mr. Tiberi for the purpose of inquiry.

Mr. TIBERI. Thank you, Mr. Chairman.

I'm going to lay this out and then ask a question of the three of you. We've heard the President say on many occasions that we here must budget our money—your money—the same way that the American people do their budgets. And I think everybody would agree with that statement, a simple concept.

I've said before in this Committee and the full Committee that my dad and mom came to America, I am the son of immigrants. My dad some years made less than other years, some years he made more. Did not believe in credit. Never spent more than he made. Simple belief. And my mother and father do well today on a fixed income, because of that belief.

Then we look at this document here, the budget. And some numbers are interesting.

When you look back in this document, back in 2007, the American people sent us $2.5 trillion to spend. We spent $2.7 trillion. We spent too much.

The deficit was about $160 billion.

Then you go to two years later. Economy goes south. We spend $3.5 trillion. The American people sent us only $2.1 trillion. Obviously, we spent too much.

Moving forward in this document, there are assumed tax increases between now and then to 2015, assuming that we catch up with those outlays, receipts go up to $3.6 trillion. My dad would say, "All right, you're starting to budget like me." No. Actually not. Outlays are $4.3 trillion. We're again spending too much.

You go to 2020, and we even get more revenue, $4.7 trillion; but we're spending $5.7 trillion. We're continuing to spend too much.

Now, everyone's fond of saying it will take both tax increases and spending cuts. Well, as long as I've been around—and I'd like to ask the former CBO Director first—have we ever actually cut spending first?

Mr. HOLTZ-EAKIN. No. We've very rarely seen spending reductions in the United States federal budget. It's continuous growth with one or two exceptions in the 1980s.

Mr. TIBERI. And my predecessor was Budget Chairman, John Kasich, and he used to say, "Cut spending first." And he acknowledged after that budget deal that they slowed the rate of growth, they didn't actually cut spending. And some of that slowing of the rate of growth was in out-years. And some of that slowing of the rate of growth actually did not occur in the out-years, because Congress overrode it.

Is that true, Mr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. Sure. I mean, this is a standard pattern. It's easy to impose out-year restraint. But when the out-years arrive, often they get overridden. The most dramatic example is the sustainable growth rate mechanism for Medicare payments to doctors, which was out-year savings of large proportions, but which gets overridden every year.

Mr. TIBERI. The question is to Mr. Greenstein. Looking at these numbers, how do I tell my mom and dad that we are serious about controlling spending, and we want to budget like them, when they spend less when they make less. We spend more when we take in less, every single year?

Mr. GREENSTEIN. Well, I think one really does need—the Federal Government actually is not the same as a family. Because it has a larger economic role in trying to prevent recessions from becoming depressions.

Mr. TIBERI. So when the President says we should budget like a family budget, you disagree with that?

Mr. GREENSTEIN. It's oversimplified.

Mr. TIBERI. Okay.

Mr. GREENSTEIN. But let me even add, most families do not limit year by year, and most businesses do not limit year by year their spending to their intake. If a business wants to expand, it usually doesn't save the money first. It borrows. That's what business loans are.

When a family buys a home or sends a kid to college, normally it takes out a mortgage or has an education loan. Now in those cases, if it's a good investment for the business, and, you know, you've made a good deal on the home, certainly getting a college education, these are good investments.

Not every investment a family makes and not every expenditure a government makes is a good investment. I'm not saying that.

I'm just saying that it does make sense when necessary for families and firms, to borrow. It can make sense for the government in a decent economic time to have a modest amount of borrowing.

But the exception is recessions. In recessions, since families can't spend more, and states have to balance their budgets, if the Federal Government had to balance its budget during a recession, it would actually make recessions much more likely to turn into depressions.

The current deficit that we are running this fiscal year is not a problem, it's not bad economics. Were we to run that same level of deficit in a non-recession year, that would be terrible economics.

So we do have to distinguish, based on the economic cycle.

Mr. TIBERI. Thank you.

Mr. BURMAN. Yeah. Thank you. I'd just like to make a brief comment, which is that the right level of spending is really for Congress to determine.

I think a big problem is that for a long time, there's been a complete disconnect between taxes and spending, so that basically spending seems like it's free. And people's taxes don't go up, you know. Spending is certainly not a recent phenomena.

President Bush said the problem wasn't taxes, but it was spending. But he also enacted the largest new entitlement program since Medicare. And in the Clinton Administration, there was a tax increase that was paired with credible reductions in the growth of spending. And I think that was a significant factor in eliminating deficits at the end of the 1990s.

So I think during normal times, setting things up so you're actually raising enough revenues to pay for government would really

focus the public's mind on whether the government is worth what they're paying in taxes.

Mr. TIBERI. Thank you.

Chairman NEAL. Thank you, Mr. Tiberi.

Now I'd like to recognize the gentleman from California, Mr. Thompson, to inquire.

Mr. THOMPSON. Thank you, Mr. Chairman. Thanks for holding the hearing, and thanks to all of you for being here as witnesses today.

I'd like to start with Mr. Greenstein. And by itself, I don't think it's a silver bullet; but I'd like to hear your understanding of how important statutory Pay-Go will help in this problem that we're facing.

As you know, it was part of how we did business in the 1990s, allowed to expire, and now back on the books. Do you have any insight on that?

Mr. GREENSTEIN. I'm a strong supporter of Pay-Go. But I think it's a necessary but not sufficient condition. Pay-Go——

Mr. THOMPSON. That was "not a silver bullet by itself" part?

Mr. GREENSTEIN. Right.

Pay-Go can be very useful in making it much more difficult for policy makers to take actions that dig the hole deeper. But Pay-Go by itself doesn't address the hole we're already facing.

That's basically the two sides of it.

There's a broader lesson there, I think, which is sometimes we look for a silver bullet, a Deus ex machine, as some kind of process change, that could somehow get policy makers to make decisions they otherwise wouldn't make.

That was the theory behind Gramm-Rudman-Hollings. Every effort on the books to force policy makers to take tough actions they don't otherwise want to take has failed. Process there is not a substitute for actually having the will, hopefully on a bipartisan basis, to act. But where a process like Pay-Go can be effective, is in restraining actions that would make things worse.

Mr. THOMPSON. Okay. I was at a briefing this morning on the whole fiscal problem issue. And I have a couple of charts here. And according to these charts, it shows that if we started to try and close this fiscal gap in 2020, it would require—if you look at just the spending cuts—a 44 percent reduction in spending; 2030 a 48 percent reduction in spending; and 2040 a 57 percent reduction in our spending.

And then the flip side of that is if you tried to do it with just tax increases, it would be a 52 percent tax increase in 2020, 64 in 2030, and an 80 percent tax increase in 2040.

And I see a couple of you nodding your head. Do you all agree with that assumption?

Mr. HOLTZ-EAKIN. Our specific figures are different. But the trend is the same.

Mr. THOMPSON. So it's about——

Mr. HOLTZ-EAKIN. And the one thing you're drawing from that is the sooner you get going, the better.

Mr. THOMPSON. It's pretty critical that we start now.

Mr. GREENSTEIN. Yes.

Mr. THOMPSON. And Mr. Greenstein called it a hole, a fiscal hole that we're in. Does that hole shallow up as TARP is paid back, the two wars end, the recession ends, and the Bush tax policy continues into effect next year? And can you quantify how shallow it gets?

Mr. GREENSTEIN. Our projections assume all those things occur, and we assume that Iraq and Afghanistan phased down, that TARP winds down, I think our projections assumed all the Bush tax cuts were continued. So it would be a little less bad if those above $250——

Mr. THOMPSON. No, his tax policy was they go back, they revert after whatever the year is.

Mr. GREENSTEIN. Yeah, our projection assumed they continued. And that AMT relief continued and the SGR relief continued, and the like. And when you make all those assumptions, you get debt-to-GDP ratio as somewhere around 300 percent or more by 2050, deficits of 20 percent or higher of GDP by 2050. And so forth.

Mr. THOMPSON. Okay. Mr. Holtz-Eakin, you had mentioned that a lot of this problem is driven by spending. And do you include tax expenditures as part of that spending problem?

Mr. HOLTZ-EAKIN. I certainly concur that lots of these refundable credits are really just outlays and disguised spending in the Tax Code.

I think it would be a very desirable thing for the Congress to change its budgetary treatment of refundable tax credits, so that every dollar was treated as——

Mr. THOMPSON. Well, not just refundable tax credits, but just tax expenditures in general.

Mr. HOLTZ-EAKIN. And there are tax expenditures as well. You know, the most prominent are tax expenditures toward housing and health insurance, which are big consumption items for the American public.

And as I laid out in my written testimony, I think moving toward a consumption-based system with a broader base and lower rates would be an enormous step forward for this country.

We're going to need every bit of growth that this economy generate, to even come close to meeting our promise of leaving the next generation a standard of living that's comparable to the one we inherited.

Mr. THOMPSON. Thank you.

Chairman NEAL. The Chair would recognize the gentleman from Oregon, Mr. Blumenauer, to inquire.

Mr. BLUMENAUER. Thank you Mr. Chairman. And we always say that we thank the Chair for this important hearing. I mean, that's almost a reflex.

But really, I think this hearing, I would love to force every Member of Congress to just take a few minutes, look at this outstanding testimony. There are some areas of difference in emphasis. But I think the main thrust is something that we ignore at our peril.

And I am hopeful that there is some way that we can work to help identify the scale of the problem, because there appears to be almost no disagreement. A minor adjustment here or there. But given the route that we're on, it's rounding error.

The clarity about the need to have a combined program of adjustment to the way that government operates, level of service—I would put in operations as well in that—and revenue increases, that you just simply can't go one way or another, I think you make a very compelling case.

Actually what you are saying is scary to the politician, because it's very easy for some to embrace the notion that it can all be adjusted through draconian spending cuts, which will never happen. But they feel better doing it, and it excites some people to hear that.

We had a bunch of people here on Capitol Hill recently, who were, you know, battling between small government and no government. But that's not where the American people are.

The flip side is this notion that somehow this is going to be accomplished merely by taxing one percent of the population or two percent of the population, or five percent of the population is likewise a fantasy.

And the way that you described both that it has to broaden and that it has to be balanced, I think is I find it compelling. I agree, and I just wish there was some way that this would be sort of in everybody on the plane when they fly home, that they'd have to look at for—well, for some of you, that's not very long, but for—yeah, okay (laughing). Well, you're a quick reader, Richie.

And the final piece that just is so compelling is that we've got to do this in the context of reform. And I personally am intrigued with looking at some variation of consumption, value added. I mean, that's another thing that distinguishes us from all these other countries.

They have a system that is a little more efficient. It's broader-based. It's not subject to the tax in political engineering that we have in this country, it appears to me.

But there's one area that I would like to just inquire a little bit. It hasn't been mentioned. And I see it as a way, perhaps of getting into them. And part of it is, I think any four members of this Committee locked in a room for 30 minutes would come up with three scenarios of what we are going to do some time to Social Security over the next ten years.

It's just a question of whether we do it now or later. I mean, there's not that much adjustment. We're going to get there. And I hope that we don't abandon the ability of our using it as a path to the future to have a rational conversation about the balance between revenue and spending.

But I am also intrigued by the utilization of user fees to be able to finance a huge deficit that we've got now with our physical infrastructure. Transportation, water, superfund. I mean, there are opportunities to have user fees that are related to beneficial use; they're related to ability to pay. They actually have broad support from the business community and organized labor and local government and academics.

Would any of you care to speculate about the role that that might have in balancing the scale and providing critical services?

Mr. HOLTZ-EAKIN. I'd like to say something about both of those issues, actually.

On the infrastructure, I commend to you the report of a bipartisan private-sector commission that I served on, the National Transportation Policy Project.

Mr. THOMPSON. Yep.

Mr. HOLTZ-EAKIN. It weighs out very clearly the needs we have for quality infrastructure, their importance to economic growth; lays out how important it is for members to define the federal role. What is the genuinely federal role in infrastructure and serve that role well?

Using user fees, so we get efficient use of the infrastructure and a funding mechanism for maintenance and repair.

So I think that's a very important thing to do. And to be done effectively, the kinds of programs we have at the federal level for funding infrastructure raise the money poorly, spend it worse. And we have to do a lot better.

On Social Security, it is imperative to get going. And this is why. I'm 52 years old, I'm the trailing edge of the baby boom generation. The tradition in Social Security has been to exclude those in retirement that's appropriate and those near retirement, who have been making plans. And the industry standard has been anyone 55 or older who's not going to be subject to a reform.

That means you have three years to get Doug Holtz-Eakin. And if you don't get Doug Holtz-Eakin, you've grandfather the baby boom. And if you've grandfather the baby boom, you've grandfather the problem.

Get to work.

Mr. GREENSTEIN. Could I add two quick points to that?

I think the user fees are a good idea and are a welcome part. One shouldn't overstate how much of the big long-term problem user fees could close. They could be a significant contributor, but it would be modest in the scale of the overall budget hole.

The other point relates to Social Security and to Mr. Thompson's question about needing to get going sooner rather than later. We do need to recognize that while we need to close the Social Security gap and while the most important thing we need to do is to slow the rate of growth of health care costs, we're not going to get big savings in those areas over the next ten years.

If we acted tomorrow on Social Security, we would phase in any benefit changes over a long period of time. The 1983 Greenspan Commission started to raise the retirement age in 2000. The 1983 increase in the retirement age isn't fully in place until 2022.

And look, there's nobody calling for repealing it. That was part of the magic of getting public acceptance for it. And in the health care area, we don't know enough yet about all the things we'll ultimately need to do.

So in the long run, health care needs to be the biggest contributor. But over the next ten years, if you're going to get the deficit down to 3 percent of GDP, frankly revenues will probably have to be the majority of that, or you're not going to get there.

Over the longer term, the Social Security savings will get larger and phase in, and the health care savings need to get much larger. But that will take a few decades.

Mr. BLUMENAUER. To the chairman's credit, we have had hearings before this Subcommittee, of the two national commissions. And I commend you for your work, and it's very helpful.

I guess, Mr. Chairman, if I could just close in 20 seconds?

Chairman NEAL. Okay.

Mr. BLUMENAUER. I don't see the infrastructure user fees as making a huge difference. I see it, though, being first of all, because of our inequities in transportation funding and the deficit, we're not subsidizing it with general fund, where we never did before. And it's going to get worse, if we don't do something.

But I see it as a way to sort of break the mind set to get started along some of these readjustments. And maybe if we prove to ourselves that we can do this with popular support, we might be able to move forward.

Thank you. Thank you, Mr. Chairman.

Chairman NEAL. Thank you, Mr. Blumenauer. The Chair would recognize Mr. Yarmuth, the gentleman from Kentucky, to inquire.

Mr. YARMUTH. Thank you, Mr. Chairman. And I'd like to associate myself with the remarks of Mr. Blumenauer virtually in their entirety.

I have one kind of supposition on the issue of family conduct versus the Federal Government's conduct. And I'll throw it out to see if anyone has a different perspective. It seems to me that when you're in a family setting, you have much greater control over the influences on your personal situation than the federal budget does and the Federal Government does.

You can insure against unforeseeable circumstances, you can insure against storms or fires. You can quickly cut your expenditures, you have some control of how much money you can earn, you can take a second job.

The government can't necessarily control for a lot of circumstances that affect their expenditures: wars, natural disasters, recessions, those types of things.

So I'm not sure it really is important, but it's more of a rhetorical comment than something that's useful in deciding what we do with this very serious real problem.

Is that a fair assessment? Or can somebody—yes, Mr. Holtz-Eakin?

Mr. HOLTZ-EAKIN. I think the important thing to recognize is that whether you believe it should add up every year, or whether you believe it should add up on average, which is I think what Bob would say—you can let the government run deficits at certain points in time—this country's federal budget doesn't add up at all, over any horizon.

And in the process, we are borrowing that money largely from those overseas, who do not share our values. And we are giving up a control that we should not cede, and are creating a danger for ourselves in the process.

That's the key issue.

Mr. BURMAN. States that need to balance their budgets actually do have rainy day funds that are supposed to be there for when, say there's a recession and there's a big reduction in tax revenues. They don't manage them very well.

But there's like this temptation to spend the money in the fund seems to be almost irresistible. But it actually would make sense to budget certainly for emergencies, because they happen. There's bad weather, there's other things.

And certainly it would make sense to budget for the commitments, and actually set aside savings for the commitments that we know we're going to have to meet down the road. But actually even if we could just balance the budget on average over the cycle, that would be a huge improvement over what we're doing now.

Mr. GREENSTEIN. I'm going to now disagree a little bit with each of my two panelists on the answers they gave you.

There's a recent article by Greg McCue, who was a conservative economist at Harvard, who was a chair of the Council of Economist Advisors for President George W. Bush. And McCue said, it is not necessary to balance the budget; but if you run deficits, they have to be modest enough that the debt doesn't grow faster than the economy.

So depending on exactly where you stabilize the debt, you can run deficits, on average, of about 2 percent to 3 percent of GDP.

Our problem is not that our long-term fiscal path doesn't reach budget balance. Our problem is that under our long-term fiscal path, even after this recession is over, deficits never get below 4 percent of GDP, and then they shoot back up.

If we were really able to get them down to 3 percent and hold them there, then we would stabilize the debt at its current share of the economy, and we wouldn't have a huge problem.

The only addendum to what Len was saying is actually our Center campaigns for states to do bigger, better-managed rainy day funds. States actually went into this downturn with rainy day funds that on average exceeded ten percent of their operating budgets, the biggest in recent record.

But state revenues have fallen so dramatically in this downturn, that they wiped out rainy day funds that would have been adequate for a recession of the 2001 variety, but not adequate for the current one.

Mr. YARMUTH. Right. I want to ask a question quickly before my time's up. One of the things we hear constantly, whether it was in the context of health care debate, or whenever we're talking about increasing marginal tax rates or whatever, is the impact on small business owners and the impact on entrepreneurial initiative, and so forth.

Is there any reliable data? I was a small business person. I have two brothers who run businesses. My father was a very successful business person. And not one of them ever did anything because of marginal tax rates.

So my question is, is there any reliable data out there, or research out there, that would establish one perspective or another on the impact on business behavior or business people's behavior, related to tax rates?

Mr. HOLTZ-EAKIN. Let me give you a self-promotional answer, which is I've written a number of articles with a variety of co-authors: Harvey Rosen, Bob Carroll, and others, which attempt to look at the influence of taxes, health care, and other policies on the start-up, the expansion, the survival of small and entrepreneurial

businesses. And we find substantial impacts of marginal tax rates on all of the decisions except the decision to start up.

So how fast you grow, how many people you hire, how much investment you make, how long you survive appear to be heavily influenced by those kinds of things.

The difficulty with any such research is, we don't get data from the IRS, with labels that say "Entrepreneur Not."

Mr. YARMUTH. Mm-hmm.

Mr. HOLTZ-EAKIN. We have to sort of make some rough justice calculations on who we want to call that. But I think there's a very good case to be made that we should be respectful of this traditional source of advantage that the U.S. has in devising all of our policies, tax and otherwise.

Mr. Burman. And most small businesses are actually fairly lightly taxed. Most of them have fairly modest incomes. And actually they've gotten tax cuts over the last ten years. Most of them were not subject to the estate tax either.

And there is some evidence that suggest that other things the Federal Government has much more of an impact on small businesses than taxes. Like, for example, procurement rules for the Pentagon and regulations.

And actually the recently passed health insurance reform I think could have a huge effect on small business, primarily by actually making health insurance a lot less expensive than it has been before, and allowing them to compete in terms of hiring workers with large firms, that have always had a huge advantage in terms of buying insurance.

Mr. Greenstein. And I'll just add, I haven't looked at this in about a year or so. But the last time we looked, something like seven times as many small business proprietors got the earned income tax credit, as paid the top income tax rate?

Most small business proprietors don't make half a million or a million a year.

Thank you.

Chairman NEAL. Thank you, gentlemen.

The Chair will recognize Mr. Heller, the gentleman from Nevada, to inquire.

Mr. HELLER. Thank you, Mr. Chairman. And thanks for putting this hearing together. And I want to thank the witnesses for being here also. I appreciate you taking time out of your busy schedule to spend some time with us.

I want to talk about some tax cuts that frankly do pay for themselves. And I want to talk about the capital gains rate, and use some examples.

And going back to 2003, we had a tax rate which was lowered from 20 percent to 15 percent in our capital gains. The year before we had $50 billion in revenue. The year that the cut was actually put into place we increased our capital gains revenues by $2 billion, the next year by $25 billion, and then another $25 billion in 2005.

The same occurred back in 1997. We had a tax rate lowered from 28 percent to 20 percent. That was in 1997. In 1996, our revenue was $66 billion. After the tax cut it was $80 billion. Went up to $89 billion the next year, and $111 billion the year after that.

So there are some tax cuts that do pay for themselves. I guess my question is, do you—I guess, Mr. Holtz-Eakin, what would you believe would be the impact of zeroing out the capital gains tax?

Mr. HOLTZ-EAKIN. I'm all in favor of that. Indeed, in my written testimony, I favor a zero tax rate on all return to capital. Dividends, interest, capital gains. It is counterproductive to attempt to tax them in the modern global financial network we live in.

So I believe there is a much better collection system that can meet the standards of fairness and progressiveness that everyone desires, but meet our standards for economic growth. And I'd be all for that.

The issue about the budget, it's not that you can't find a couple of years where your cut rates and revenues go up thereafter. I would never dispute that.

I think that way of framing the problem makes two mistakes.

The first is, you want to set in place a Tax Code, which is stable for the long term, and so it's sort of the long-term revenue generation that I care about.

And number two, that makes it sound like taxes are somehow about balancing the budget. I want a tax policy that supports economic growth, and interferes as little as possible with the private sector, while paying the nation's bills.

I mean, those should be the standards by which we conduct these things.

Mr. HELLER. Are you familiar—and my colleague, Mr. Linder, brought this to our attention—the Howser Law talks about the federal tax revenue and the marginal tax rates between 1950 and 2007. And it talks about the top individual tax brackets as early as 1950, which was nearly 90 percent, and brings it all the way down into back in the 1970's, where it was about 70 percent. Of course the Reagan tax cuts came in to about where we are today, at nearly 40 percent.

And yet, the revenues as a percentage of the GDP, has stayed constant. Can you explain that?

Mr. HOLTZ-EAKIN. I won't attempt a complete explanation of Mr. Howser's finding. But I'll make the following observation. Which is, a lot of people have noted that we've raised the same amount of revenue on average for the federal budget.

But the way we raise it matters. We had very high marginal tax rates in the 1970s, we had terrible economic performance. We might have raised the same fraction of GDP in revenues, but we didn't do very well.

We got marginal rates down, we broadened the base, we had a system that supported much stronger economic growth, survived through the 1980s and 1990s. I think we ought to set that as the standard for the way we raise taxes in the United States.

Mr. HELLER. Thank you. I yield back, Mr. Chairman.

Chairman NEAL. The Chair would recognize the gentleman from Illinois, Mr. Roskam to inquire.

Mr. ROSKAM. Thank you, Mr. Chairman. Earlier, Mr. Greenstein and Mr. Holtz-Eakin expressed sort of different opinions—surprise, surprise—about worldwide tax treatment of American corporations or worldwide American corporations. And Mr. Tiberi and

I have spent a lot of time talking with a lot of folks around town and also back in our districts on this issue.

And obviously it became a big issue with the President identifying that as a pay-for for health care. It was passed over this time, but clearly it's back into the mix.

Mr. HOLTZ-EAKIN, could you give a sense of perspective about the tax consequences, sort of the business activity consequences of taking this up, this sort of tax treatment, and put it in a little bit of a context for us?

Mr. HOLTZ-EAKIN. Well, I think this is an important issue that this Committee is doomed to spend a lot of time on going forward. It will be the case, necessarily, that we will have to rely more on exports as a source of our economic vitality going forward. As a result, we are going to have to think about all policies through the lens of international competitiveness.

Our tax system is one of those things. We do have the only tax system left, which attempts to tax on worldwide income instead of just on the income earned in the United States on a territorial basis.

This puts us at a big disadvantage when firms choose where to place their headquarters. And we've seen, for example, Anheuser-Busch becoming a subsidiary of InBev. And many other tax-related transactions of that type are coming.

I think that's a very bad thing, because the evidence suggests that once you lose the headquarters, you then quickly lose the research and development, and then the manufacturing.

This is one of the reasons that this becomes increasingly clear that the real burden of the corporation income tax is falling on American workers.

When I was at CBO, we did a study that showed that of every dollar in corporation income taxes that are paid, 70 cents comes in the form of lower wages and benefits for workers.

I don't see why we would want to have a tax system that systematically harms our workers and impedes their ability to sell around the globe. I think it's a big issue for this Committee.

Mr. ROSKAM. Mr. Greenstein, I wrote it down, and it's a paraphrase. I don't think you'd object to my paraphrase that your arguing the actual U.S. corporate tax rate is comparatively low, or more competitive than people like Mr. Holtz-Eakin would represent.

Give it your best pitch. I just remain so incredibly unconvinced. But it's my time, let's use it. Give me your best pitch on why that's——

Mr. Greenstein. You——

Mr. ROSKAM. I'm not hearing it from anybody else.

Mr. GREENSTEIN. Okay. I actually think I may not have expressed it clearly in summarizing my testimony in five minutes. But your paraphrase really isn't exactly what I'm saying.

Mr. ROSKAM. Okay. Fair enough. What is it?

Mr. GREENSTEIN. I would very much agree—I doubt that many people would disagree—that the current structure of the U.S. corporate income tax poses competitiveness problems.

What I was saying is that the problem does not come from the total amount, the total dollars in corporate tax income we collect. We actually collect as a share of—this is the Bush Treasury De-

partment study, I have it in my hand—it tells you that from 2000 to 2005, the United States U.S. corporations paid an average of 13.4 percent of their profits in the corporate income tax, and the OECD average was 16.1 percent.

That's not uncompetitive. The competitiveness problem comes from the wild inefficiency of the structure of our corporate income tax today. We have a high marginal rate. The code is shot through with all sorts of special preferences.

You have some groups of corporations that pay high average effective corporate tax rates. You have certain kinds of corporations that pay close to negative corporate tax rates. We have inefficiencies across boundary countries. We have inefficiencies between different kinds of industries. In the U.S. you have inefficiencies compared to whether you debt finance your business or you save up the money and don't borrow.

The point that I was trying to make is that we could do major corporate tax reform, greatly address a number of these competitiveness and inefficiency problems, and actually take in somewhat more revenue at the same time, and be more competitive and economically efficient.

I was not——

Mr. ROSKAM. I got it——

Mr. GREENSTEIN. Defending the current structure.

Mr. ROSKAM. Fair enough. Which is why I didn't interrupt you.

So would you agree with the premise, would you accept the premise that if worldwide American corporations were paying more in taxes than their international competitors, that the net loser in that equation would be American workers?

Mr. GREESTEIN. Actually, one of the first things I would do when asked that question, seriously, because I'm getting beyond my expertise, would be to ask somebody like Len Burman that question.

And the question I would want to know, clearly, if you were asking corporations to pay dramatically more as a share of profits than corporations in other countries, you would probably be harming workers and investors both.

The thing I'm less clear about is if the differences were small——

Mr. ROSKAM. I understand——

Mr. GREESTEIN. Would the impacts be very noticeable?

Mr. ROSKAM. I understand. You know what? I'm out of time. I don't want to abuse the time. But I'm happy to——

Chairman NEAL. I——

Mr. ROSKAM. You're dying for the answer, aren't you?

Chairman NEAL. I'd like to hear what Burman's got to say. Once he moved into Burman, I said "We're on."

Mr. BURMAN. Thank you, Mr. Chairman. Thank you, Mr. Roskam.

You know, the research on the incidence of the corporate taxes is all over the map. For a long time, the economists believed that most of the incidents fell on capital, that is, investors were the ones that paid the tax.

Different models can produce different results. Even the study that was produced in Doug's CBO, which was an excellent study,

said that the results depended a lot on assumptions about parameters, which was a huge amount of uncertainty.

So it could be that a smaller share of the tax is borne by workers.

The ideal tax system would be one where the corporate tax was basically just a withholding tax, and that ultimately the tax would be paid by shareholders. So at least if you have an income tax, Doug would say you shouldn't tax savings at all.

The reason you need a corporate tax primarily is because if corporations were untaxed, they would become a tremendous tax shelter. People would hide their income in corporations and use it as a way to avoid tax for a long period of time, including tax on labor income.

The same kind of problem occurs with capital gains. If you had a zero capital gains tax rate it would open the flood gates for tax avoidance by most high-income people. And in fact, that happens even now with the 15 percent rate.

So if you want to tax capital income—and we can talk about whether you want to do that or not—the issue is as in a lot of cases, it's between fairness and economic efficiency. But if you want to tax capital income, you can't have exemptions for particular forms of income. Otherwise, you have a huge incentive to convert whatever's highly taxed and what's taxed less.

And you know, whatever else you think the tax system ought to look like, that's completely wasteful. You have people whose whole occupation is figuring out ways to avoid tax for high-income people. And they're smart people. They could actually be doing something productive otherwise.

Mr. ROSKAM. And then just to yield back in just a second.

Mr. BURMAN. Sure.

Mr. ROSKAM. You know, it seems like you're arguing a truism in a way, that the tax policy has consequences in real economic life. And that's interesting, but it's not revelatory.

Mr. BURMAN. But it's actually relevant that if you want to tax income, and you want to try to tax different forms of income the same, so that you're not creating these opportunities for shifting from one form to another.

Mr. ROSKAM. Right. Thank you.

Chairman NEAL. I thank the gentleman.

I think we can get the questioning in here. We have two panelists, who would still like to inquire, and the Chair would recognize the gentleman from New York, Mr. Crowley, to inquire.

Mr. CROWLEY. Thank you, Mr. Chairman. There's general agreement that the nation's deficits are too large. I say generally, not universally but general agreement.

[Buzzer goes off.]

Mr. CROWLEY. And they're off. I believe, as many of my colleagues, I think on both sides of the aisle agree, that we need to address this issue, both for now and for the long term.

But we need to make sure that we know all the facts and that they're in place. When President George W. Bush became President, with strong majorities of his party in the Congress, the federal debt stood at $5.7 trillion and the U.S.A. enjoyed annual budget surpluses.

Eight years later, when George W. Bush left office and the overall majority of his term being served by a Republican Congress, the nation's debt stood at over $10.6 trillion, a $5 trillion increase over that time.

China became our nation's biggest lender, and the nation was running trillion-dollar annual deficits, thanks in part to a $700-billion kiss to the nation's banks from the Republican party and President Bush.

Those are facts. Now in the past two years the debt has increased another $2 trillion, with most of that being dedicated to fighting the recession. But to insure that we reigned in our nation's debt and end the Republican policies of borrow and spend, this caucus, the Democratic caucus, passed and President Obama signed into law Pay-Go, or pay-as-you-go budgeting legislation, which means that all new spending or tax cuts must be fully offset or paid for, so that it does not add to our nation's deficit.

Essentially this acts as a giant check on the spending and borrowing power of Congress. It worked in the 1990s and I believe it will work again.

Democrats have ended the days of credit card living in Washington. Congress is starting to manage the Federal Government like the way our constituents manage their own household expenses.

Republicans who cry about deficit spending, oppose this measure and oppose common sense solutions to address our nation's deficit.

Republicans have also opposed common-sense tax loopholes closures, like allowing rich Americans to avoid taxes by hiding their income in Swiss bank accounts without punishment.

Now maybe I shouldn't say that these are all rich Americans. But I know there aren't too many people in my district in Queens and the Bronx with Swiss bank accounts.

Now Republicans will oppose legislation to close tax loopholes that allow foreign companies to avoid paying U.S. taxes, giving them an unfair competitive advantage over U.S. companies.

I think we should be putting Americans and America's workers first. And I wish my Republican colleagues would join me in that thinking.

These are near-term ways to address our nation's debt. In the long term, the President has just signed legislation this afternoon to provide near universal health care through the free market to all Americans, and this bill will save Americans $1.3 trillion over the next 20 years, according to the CBO. Now this is the non-partisan reliable Congressional Budget Office.

Mr. Holtz-Eakin, do you trust the number crunchers at the Congressional Budget Office? Yes or no?

Mr. HOLTZ-EAKIN. Yes, I do.

Mr. CROWLEY. You do. I thank you for agreeing that those numbers are accurate.

Mr. HOLTZ-EAKIN. No, I did not say that.

Mr. CROWLEY. But you trust them?

Mr. HOLTZ-EAKIN. I trust the number crunchers, but not the numbers.

Mr. CROWLEY. You trust the number crunchers, but so the determinations which come out there, their analyzing of the facts are inaccurate? You said one or the other.

Mr. HOLTZ-EAKIN. They are, by law, required to analyze the proposals as written by the Congress. And if the Congress leaves things out, as this Congress did, they don't price them. If this Congress makes assumptions that I believe to be politically unrealistic, they can't make that judgment. I couldn't when I was at CBO, and did not. It's not their role.

And so I think there's a distinction between trusting the number crunchers and believing the projections that come out.

Mr. CROWLEY. Well, according to the CBO, the number crunchers that you trust, the CBO has stated that the bill that was just signed into law today will save the American taxpayer $1.3 trillion in future debt. The only people that I think who would object to that would be the Chinese bankers, who have thrived during the eight years of Republican controlled Congress here in the House and Senate, and that presidency.

The expected deficit for the Fiscal Year 2010 for the U.S.A. is $1.3 trillion. The total amount of discretionary funding passed by Congress for 2010 is: Non-defence $670 billion, defense $556 billion, for a total discretionary spending of $1.2 trillion.

So if the government stopped all food safety inspection, stopped patrolling the borders, ended homeland security protection, closed down the national parks, completely defunded the military, and stopped funding for all transportation projects for the entire year, we would not close the deficit. We would still have a deficit.

This shows that spending is only a small part of the problem. So it's factually wrong to say it is spending alone that is causing our debts.

And I see my time has run out. I want to give my colleague an opportunity to ask a question as well. With that, I'll yield back the balance of my time.

Chairman NEAL. I thank you, gentlemen. The Chair would recognize the gentleman from Texas, Mr. Doggett, to inquire.

Mr. DOGGETT. Thank you, Mr. Chairman, and thank you, Mr. Crowley.

I'm interested in the testimony concerning tax expenditures. While I think we may bring different perspectives or reasoning, that there is a growing point of view ranging across philosophical lines that the complexity of our Tax Code, and our use of the Tax Code for what is really expenditure purposes needs to get further review.

I gather, Mr. Holtz-Eakin, that you agree we need to focus attention on the deductions, the credits, the preferences that are in our Tax Code, that amount to a form of expenditure, in the same manner that we focus on direct expenditures.

Mr. HOLTZ-EAKIN. Oh, yeah. Let me take this opportunity to agree with both Len and Bob Greenstein on something. Len and I would disagree on the ideal tax system, but many of the tax expenditures would be the same problem in both our systems.

Mr. DOGGETT. Right.

Mr. HOLTZ-EAKIN. So we'd agree on things we needed to close, especially consumption items that are being favored. And I agree with Bob a lot about difficulties in the corporation income tax.

The biggest obstacle to serious tax reform will be the business community, because they always hate having their own rifle shop's preferences taken away; but it really needs to get done.

Mr. DOGGETT. Thank you very much. And with that in mind, though not targeting any particular tax provision, I included in the version of the extender's legislation that passed the House in a December, a study—and I think you made reference to that—so that we would at least begin an evaluation process of the extender provisions that you're always at work on that, Mr. Barthold?

Mr. BARTHOLD. We're trying, Mr. Doggett. The Congress has kept us pretty busy on some other issues.

[Laughter.]

Mr. DOGGETT. I know we have——

Mr. BARTHOLD. But I will say that yes, we are at work.

Mr. DOGGETT. But I gather all of you also agree that we need to be in the extender, since they come up every year or every couple of years, that we need some systematic evaluation of those and what purposes they accomplish, in much the same way we would hope we get for direct expenditures.

Mr. Burman. Yeah. And I would actually apply the same scrutiny to programs that don't come up for extension every few years.

Mr. DOGGETT. That's the next step.

Mr. BURMAN. Yeah.

Mr. DOGGETT. Is to try to see it applied more broadly. Because these tax expenditures—and you mentioned the low-income housing tax credit—I authored the higher education tax credit, about $13 billion worth, in the stimulus. But it seems to be we need to be looking at how effective that is as a mechanism versus some of the direct expenditure programs in determining what the benefits are, though one's through the Tax Code, and one's through the appropriations bill.

Mr. BURMAN. I think you know this. But I mean, the extender exercise itself is very revealing of the problems we're facing.

You think of the research and development tax credit. It makes no sense from an economics point of view to have this extended year by year by year. We can't do a long-range research and plan in the presence of that. It's being done strictly for budgetary reasons.

So it is time to be honest about what we're spending and finance it, and put in place something that is a long-run incentive to do the kinds of innovations we need in the United States.

Mr. DOGGETT. As well as specifically on that, the report of the Government Accountability Office to really look at credits like that, to see if they are serving their purpose, and are spurring research, or simply rewarding conduct that would have happened anyway.

Mr. GREENSTEIN. Let me say, there are two additional issues. I don't have the answer to the question I'm about to raise of precisely what we should do; but I think we need to think about some different kind of or additional kind of budgetary presentation on tax expenditures.

Actually, Doug referred to refundable tax credits before. They are the ones that do get the most attention now. All of the refundable part of the refundable tax credits show up in the budget as outlays, not as revenue reductions.

But all the other tax expenditures that show up as revenue reductions, they all just get buried in this overall 18 percent of GDP, or whatever it is the current figure is, you know, for revenue collections.

And if we could somehow break them out and highlight, whether we call them outlays—maybe we make up a different term, because they're not precisely the same—but something that highlights how they're different from other parts of the Tax Code.

You know, I don't think many people understand we have subsidies in spending and we have subsidies in the Tax Code.

So that child care program for low and moderate income families, the block grant. So that's just—that's government spending, that's big government. But for middle and upper income families, we give them a child care subsidy too. We do it through a tax break, a tax credit. And that sort of is, oh that's good, because that's a reduction in taxes owed.

And we need some kind of leveler playing field, where subsidies are viewed as subsidies, whether they're on the spending or the tax side of the budget.

Mr. DOGGETT. Thank you, Mr. Chairman. Thanks to each of you.

Chairman NEAL. I thank the gentlemen.

I want to thank our panelists today for their testimony on this important subject. You may receive some written follow-up questions from members, and I hope you will respond promptly, so that we might include those responses in the record. And personally, I want to say thank you. This was very helpful, very considerate. Thank you.

This meeting stands adjourned.

[Whereupon, at 4:08 p.m., the Subcommittee was adjourned.]