Congressional Research Service

MEMORANDUM February 19, 2010

To: Senator Ron Wyden
Attention: John O'Neill
and
Senate Budget Committee
Attention: Jim Carter

From: Maxim Shvedov
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and
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Subject: **Revenue Estimates for Proposed Tax Reform**

This memorandum responds to your request for updated preliminary revenue projections for your broad tax reform proposal, based on S. 1111 (110th Congress), as modified. This memorandum is designed to assist you in refining your legislative proposal. It does not analyze any legislation under current consideration.

We updated our previous estimates for the provisions of S. 1111 (with methodology described in detail in our memorandum to you of April 12, 2007) and also made adjustments for modifications to S. 1111. These estimates are unofficial, "ballpark" numbers, sensitive to many assumptions and limitations. Estimates of the proposal by the Joint Committee on Taxation (JCT) would, of course, constitute the official estimates.

The most significant provisions of the current proposal affecting individual taxpayers are:

- reducing the number of income tax brackets from six to three;
- increasing the amounts of the standard deduction;
- capping the top tax rate at 35%; and
- allowing an exclusion for capital gains, with the remaining 65% taxed as ordinary income and shortening the holding period to qualify for the exclusion to six months for capital gains of $500,000 or less.

The individual income tax modifications to S.1111 include eliminating the refundable state and local tax credit approach and retaining the itemized deduction, modifying the 15%/25% single rate brackets to end at $37,500/$70,000, with twice those amounts for married taxpayers, allowing the capital gains exclusion provision, and adding the Retirement Savings Accounts and Lifetime Savings Accounts as proposed by the George W. Bush Administration.

On the corporate and business side, the proposal, as modified, establishes a single corporate income tax rate of 24% and allows a simplified cash flow accounting for businesses with gross receipts of less than $1 million per year (with land and buildings excluded).

As in S. 1111, numerous corporate and individual preferences are eliminated.

As requested, we estimate the changes relative to President Obama's budget as fully enacted (BFE) baseline. You also requested a winners and losers analysis relative to the current policy extended (CPE).

Our rough projections indicate that the individual income tax provisions of the revised proposal are likely to gain revenue of $45 billion between FY2010-2019, relative to the CPE baseline and lose revenue of $148 billion between FY2010 –FY2019 relative to the BFE baseline. (The estimates for the cash flow treatment of small businesses are included in this individual estimate while other business base-broadeners are included in the corporate estimate.) We generated the estimates by applying some of the proposed changes to the individual-level taxpayer data for 2004 and relying on the JCT estimates for the rest of the proposed changes,[1] except for cash flow accounting, which we estimated separately. The resulting change in taxpayers' liability is extrapolated into the future using the Office of Management and Budget's (OMB's) revenue projections and the Urban-Brookings Tax Policy Center's alternative minimum tax (AMT) estimates.

The corporate tax rate reduction and business base broadening provisions are estimated to lose $540 billion over FY2010-2019 compared to the CPE baseline and $707 billion compared to the BFE baseline. The corporate base broadening provisions are also in S. 1111; we adjusted those values to account for the tax rate reduction.

You propose specific revenue offsets that may reasonably be estimated to raise $662 billion over FY2010-FY2019. Taking into account the $662 billion projected revenue gain, our analysis suggests that it is reasonable to expect the proposal to lose approximately $230 billion over ten years relative to the BFE baseline. It would also be likely to benefit an average taxpayer with adjusted gross income below $200,000, even though some taxpayers in that income range may experience a tax increase.

As you indicated, your plan proposes to close the $230 billion gap by cutting an average of $23 billion per year from corporate and business-related spending and transfers. The National Income and Product Accounts identified $50.6 billion in subsidies for 2008 and a study by Slivinski identified $92 billion in spending in 2006 he characterized as business subsidies.[2] If Congress were to make these cuts, our estimates indicate the proposal would be deficit neutral.

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[1] These estimates were based on Joint Committee on Taxation, Estimates of Tax Expenditures for FY 2008-FY2012, October 31, 2008.

[2] National Income and Product Accounts Table 3.13: Subsidies, http://www.bea.gov/national/nipaweb/TableView.asp?SelectedTable=111&Freq=Year&FirstYear=2007&LastYear=2008; Stephen Slivinski, The Corporate Welfare State: How the Federal Government Subsidies U.S. Businesses, CATO institute Policy Analysis No. 592, May 14, 1007, http://www.cato.org/pub_display.php?pub_id=8230.

It is important to stress that the estimates are very rough. Due to data and resource limitations, the calculations do not incorporate rigorous estimates of certain provisions, but rather use available approximations. For example, the JCT estimates were added without any modifications, but the JCT revenue estimates omit interactive effects, which could be significant. However, since the provisions are so disparate, it is not feasible for CRS to analyze each one separately. Estimates not available from the JCT were made by CRS (as described in the April 12, 2007 memorandum). Numerous other assumptions were used in the process, some of which may materially affect the results. Changes in projections or various legislative activities would also affect the revenue impact. Finally, the estimates exclude many behavioral, feedback, and cash-flow effects.