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PRESIDENT'S FISCAL YEAR 2007 BUDGET (REVENUE PROPOSALS)

HEARING

BEFORE THE

COMMITTEE ON FINANCE
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CONTENTS

OPENING STATEMENTS

ADMINISTRATION WITNESS

ALPHABETICAL LISTING AND APPENDIX MATERIAL

PRESIDENT'S FISCAL YEAR 2007 BUDGET (REVENUE PROPOSALS)

TUESDAY, FEBRUARY 7, 2006

U.S. SENATE,
COMMITTEE ON FINANCE,
Washington, DC.

The hearing was convened, pursuant to notice, at 9:30 a.m., in room SD–215, Dirksen Senate Office Building, Hon. Charles E. Grassley (chairman of the committee) presiding.

Also present: Senators Hatch, Lott, Snowe, Kyl, Thomas, Bunning, Baucus, Rockefeller, Conrad, Jeffords, Bingaman, Lincoln, Wyden, and Schumer.

OPENING STATEMENT OF HON. CHARLES E. GRASSLEY, A U.S. SENATOR FROM IOWA, CHAIRMAN, COMMITTEE ON FINANCE

The CHAIRMAN. We welcome Secretary Snow back. This will be the first in a series of hearings that the Finance Committee will hold on the administration's budget. Today we focus on the revenue side. The Secretary will be our sole witness today.

The President now has presented his State of the Union address, and he rightly noted in that address the tone in Washington, DC. Hopefully, everyone from the President on down will keep a commitment to problem-solving, civility, and discussion and, most importantly, bipartisanship.

I do not think I have to remind people listening, but I think this committee has a very good reputation for bipartisanship. I think we are all committed to maintaining that, regardless of what the President said in his State of the Union message.

In that spirit, I would like to start out with some positive news that every member, conservative, moderate, liberal, Republican, Independent, or Democrat, would find satisfying, and that is that Federal revenue is up.

The good news is, we are way ahead of where we thought we would be at this point last year. Revenue is up $274 billion in 2005 over 2004. That happens to be a record.

Back in 1993, taxes were raised. Then-chairman of this committee, Daniel Patrick Moynihan, termed that bill "a world record tax increase." In fact, the revenue raised here in the last 12 months in terms of year-to-year change is much higher than that was, even when there was a tax bill passed to raise taxes. The good news is that the additional revenue came in without raising taxes on the American taxpayer.

A lot of times around here people get it backwards. You have heard about the old-country saying that goes something like, the tail does not wag the dog, the dog wags the tail. Some people think that the only way to fix a budget is to raise taxes.

A tax increase, they believe, will make the economy better. It is kind of like the Federal tax tail wagging the American economic dog. I have a chart here. Now, I kid my friend from North Dakota that I may not have as many charts as he has. It is not an effort to denigrate your State at all. I do not have as many charts as what he is going to show you, but we have quality charts. [Laughter.]

I should take my wife's advice. Every time I try to be funny, I screw up. [Laughter.] So I am going to listen to Mrs. Grassley the rest of the time.

[The charts appear in the appendix on page 49.]

If you take a look at this chart, members of the committee and Mr. Secretary, you will see that the Federal revenue responds fairly dramatically to the economic growth.

Take a look at those peaks and valleys as I explain here. In times of good economic growth, Federal revenues rise. In times of economic recession, Federal revenues decline. I am not going to point to all of those because I think it is pretty clear. There are just two lines there.

So in the case that I am talking about, when we put in place a tax relief program in 2003, economic growth started back up. Now, some would protest that this was a bad move. They claim that this tax relief, especially with respect to the encouragement of investment income, made the budget and the economy worse.

In fact, as you can see from this chart, it shows just the opposite. Growth has spiked up and so have Federal revenues as well. As you see, the big, high point there, the red mark, in year 2005 is the figure that I gave earlier in my remarks.

Now, the bottom line is that everyone should be happy that the economic dog, a growing national economy, is wagging the Federal revenue tail. It means more Americans are working, investments are performing better, and more money is coming in to the Federal treasury. Everybody wins under this scenario.

I would like to bring out the other, and last, chart that I think puts the revenue side of the Federal budget into perspective, a perspective of over the last 50 or 60 years, I guess. This chart shows that, over the post-World War II period of time, Federal taxes have taken around 18 percent of our economy.

Now, that is a 60-year average. It shows that we had a sharp drop in the wake of the stock market bubble, 9/11, and other factors in the early part of this decade. That is that very low dip that you have there in 2002 and a couple of years beyond.

Now, with all of the bipartisan tax relief in place, we are on a path that gets us pretty close to the historical average of 18 percent over the last 60 years. Now, if you look closely, you will see that once the effect of the tax relief sunsets out there in the year 2010, that, not surprisingly, as a percentage of GDP, taxes will still be far above that historic average.

Now, some would like to go that way right now. My concern is that the effect is that the revenue tail would be the focus. We would be taking our eye off the ball—or in this case, as I have been using the dog as an example, off the dog—of our growing national economy.

Now, I am not saying that there are not problems with the budget in the mid- and long-term. We all know there are, and that is going to be emphasized by a lot of members of this committee, both Republican and Democrat.

Certainly these projected deficits have to be dealt with. The deficits, however, are driven by Federal spending. Federal spending is off the track. It is high as a percentage of our economy. It is trending between 1 and 2 percentage points higher than the historical average of the revenue that has been coming in to the treasury, which is that dotted line. It is on the spending side, not on the revenue side.

As you see, the projected gross of revenue coming in for the next several years, and ending up at the time the tax decreases sunset, will be way above the historical average.

The critics of a bipartisan tax relief plan come to the table with one agenda only: to raise taxes. The harshest critics are those who are least willing to look at the spending side of the ledger. That is where the problem is. Just look at how hard it was for us to get a bipartisan deficit reduction bill through the Senate.

Since today's hearing is about revenues, I wanted to put this part of the budget into context. I want us to reflect on the good news of a growing economy, the program of bipartisan tax relief, and the growing amount of Federal revenue. There is good news, but we must have tough news in that we have to get the spending side of the budget under control.

Mr. Secretary, today we will examine the administration's budget revenue proposals. We look forward to constructive discussion in these areas.

Now I would call on my friend, Senator Baucus.

OPENING STATEMENT OF HON. MAX BAUCUS, A U.S. SENATOR FROM MONTANA

Senator BAUCUS. Thank you, Mr. Chairman. Mr. Chairman, I appreciate very much your statement there. I just think it is important for us to remember, too, that there are lots of sides to this budget.

I think it is important that we not get too hung up on matters such as percentage of revenue 1 year as opposed to another, because, although that is interesting, it really, in my judgment, does not get to the heart of the matter, and that is, what are the budget choices we are making here and what does that imply for our future?

The proverb says, a good man leaves an inheritance to his children's children. Today we discuss the budget and American competitiveness. The budget is a statement about what kind of world we will leave to our children and our children's children.

Will we leave them prosperity or will we leave them debt? Will we leave them better jobs or will we leave them Third World wages? Will we leave them a brighter life or will we leave them a standard of living in decline? That is what the budget is about, and that is why we must focus on America's competitive place in the world.

For the last 5 years, the Federal budget has left debt to our children. The President's budget released yesterday continues that legacy in the current year, the next year, and the years beyond. From 1997 to 2001, the Federal debt held by the public declined by about $1,600 per person. That lightened by $6,400 the burden hanging over every family of four.

But since 2001, the government has been adding burdens to our children and our children's children. The budget before us today shows that, from the end of fiscal year 2001 to the end of fiscal year 2008, this administration will have added more than $7,700 in publicly held Federal debt for every man, woman and child in America.

That is about $31,000 of new debt for a family of four, thanks to the current budget policies. That is one way in which this administration's fiscal policies are taking from our children and our children's children.

Moreover, the government borrows much of this money from central banks in China, Japan, and other foreign country's institutions. America is borrowing 80 percent of the world's annual savings.

Let me repeat that statement: America is borrowing 80 percent of the world's annual savings. We are handing our children and our children's children a set of obligations that they will owe to foreign central banks.

The budget affects whether our children will receive the education they need to compete. The budget affects whether health care costs will hobble American families and businesses. The budget affects whether American research and development will remain on the cutting edge.

I am not saying that crafting the budget is easy. We all agree that we need more funds for our troops to ensure our National security. Yet I want to leave to our children and our children's children an economy where health care coverage is our economy's strength, not its greatest burden.

I want to leave to our children and our children's children an economy where workers and companies look to foreign shores with hope and ambition, not fear and trepidation. I want to leave to our children and our children's children an economy that sets records for investment, not records for deficit.

Whether we succeed or fail is a matter of choice. Will we choose to invest in education? Will we choose to re-think how we fuel our economy and our cars? Will we choose to guarantee that every American has health care coverage? Will we choose to discipline our budget?

I believe that our country is ready for tough choices, so I have spent much of the last year developing an agenda to help us make the right choices to ensure that we have a competitive economy in the future.

Over the past 7 months, I spoke on the floor of the Senate to identify seven key areas that determine economic competitiveness. These areas are: education, energy, health care, research and development, taxes, international trade, and national savings.

Two weeks ago, I unveiled a detailed seven-part plan for ensuring our economic competitiveness now and in the future. I was heartened that the President's State of the Union address, and now his budget, included proposals for improving our economic competitiveness. I look forward to working together with him, and with the Chairman of the committee, to enact these proposals.

But the President's plan is not bold enough. It needs to be much bolder. In some areas, the President's plan goes in the wrong direction and should not be adopted.

Here is how a couple of the areas shape up. On education, clearly, we must improve math and science education, as the President indicated. But I do not want to just encourage kids to take math and science, I want them to know that if they take those classes and choose to major in those subjects, we will make their college tuition free.

The President wants to bring more math and science professionals into the classroom. I want to double their salaries and keep them there.

On energy, I am for increasing research that can lead to energy independence, as the President wants, but I do not want to just increase funding. I want to create an Advanced Research Projects Agency for Energy, ARPA-E, an independent arm with the Energy Department that would follow the lead of DARPA and Defense, to find the most cutting-edge solutions to our energy problems. It would help to shake up our addiction to foreign oil.

On health care, competitiveness demands that we address the spiraling health care costs. Compassion demands that we extend the security of meaningful health insurance coverage to millions of uninsured Americans. I am concerned that the President's budget proposals would do little or nothing to reduce costs or expand coverage.

Moreover, his emphasis on health savings accounts and high deductible policies could make meaningful coverage even less available to those who most need it.

I am also concerned at the President's emphasis on individual health insurance plans that would undermine coverage for the more than 60 percent of Americans who get health care insurance through their employers.

In my State of Montana, 52 percent of the non-elderly have coverage through their employers; 9 percent of Montanans have individual insurance. We need to treat that 9 percent fairly, but without undermining the employer-based system that covers 52 percent of our citizens. We need to extend coverage to the 22 percent of Montanans who have none at all.

On research and development, clearly we must make the R&D tax credit permanent, as the President wants. But I also want to simplify and streamline the credit to make sure that American innovators can get it and use it to do great things.

On savings, I am for increased savings, as the President wants. We need to increase savings to spur increased investments. Increased investment spurs greater productivity, and greater productivity makes our products more competitive in the global economy.

But his proposals on personal savings create incentives for those who already save to move their funds around, and they will not have the effect of increasing personal savings. Rather, we must provide workers with new opportunities to save and help those with too little income to benefit from current tax incentives to save for the future.

We cannot forget public savings. When governments run surpluses, they contribute to savings. When they run deficits, they detract from savings. This administration has been running massive deficits.

We need tough pay-go rules to force the President and the Congress to pay for any new entitlement spending or tax cuts. We did not have those rules during the last few years, and this contributed to deficits becoming far too large. Will we have such rules in the future? I hope so. But, unfortunately, the President opposes them. I think they are critically necessary.

Let us choose to be good public servants. Let us leave an inheritance of prosperity, not debt, to our children and our children's children. Let us leave them a brighter life in the competitive world to come.

The CHAIRMAN. Thank you, Senator Baucus.

Now we go to our Secretary, who needs no introduction. Welcome, Secretary Snow.

STATEMENT OF HON. JOHN SNOW, SECRETARY, U.S. DEPARTMENT OF THE TREASURY, WASHINGTON, DC

Secretary SNOW. Thank you, Mr. Chairman, members of the committee. I thank you again for the opportunity to be here. This is my fourth appearance, Mr. Chairman, as you know, before this committee to discuss the President's budget. We meet at a time when the American economy is performing very, very well. We are on a good path.

We are on a path that sees the economy growing at a good, healthy rate. We are on a path that sees the American economy creating lots of jobs. We are on a path that sees the unemployment rate coming down.

Last Friday's numbers indicated that labor markets are strengthening and unemployment is now down to 4.7 percent. I think when I first appeared before you it was over 6 percent. In that interim period, there have been 4.7 million jobs created.

Capital spending, which had been anemic, Mr. Chairman, as you know, when I first appeared before you in February of 2003—had been weak for a number of quarters—has now been strong for a number of quarters. So we are on the right path.

When we ask ourselves why, we see the role of this committee, the Congress, you, Mr. Chairman, in making possible the tax cuts of 2003, which stand right at the center, right at the heart of the strong recovery we have seen since they were signed into law in May of 2003.

This budget would continue the economic policies that brought prosperity to America. It would continue the low tax environment that you talked about in your opening statement. By making the tax cuts permanent, it would avoid raising the level of taxes to a level which is well above the historic average in the United States.

Keeping tax levels at the historic average makes a lot of sense. It is consistent with better economic performance, more growth, more capital formation, and, Senator Baucus, better long-term out-looks for our children and grandchildren, because, when we have capital formation, we are promoting growth in the future.

This budget also is committed to fiscal discipline. It holds government spending below the level of inflation. In the non-security, non-homeland area, it reduces actual spending.

It is consistent with the President's commitment to cut the deficit in half by the time he leaves office. We are well on the way to do that. If it had not been for Katrina and the Katrina effects, we would have seen the deficit come in much lower this year after coming in for fiscal year 2005 at a level that was about 2.6 percent of GDP, and we are on a path to bring us below 2 percent by the time the President leaves office.

So the economy is strong. We are on the right path. Government revenues, as the Chairman's chart shows, are at the highest level ever in American history, and that is with the lower average tax rates, lower marginal tax rates. More Americans are working than at any time in our history. More Americans own their own home than at any time in our history.

The net wealth of the country is the highest at any time in our history, and the GDP is far and away the highest than at any time in our history. I would urge you, Mr. Chairman and members of the committee, to continue the good policies reflected in this budget which have us on a good path.

With that, I would be pleased to try to respond to your questions.

[The prepared statement of Secretary Snow appears in the appendix.]

The CHAIRMAN. Mr. Secretary, I am glad to see the President's budget has put a lot of focus on health care. I know this is an issue that all of us here in the committee hear a lot about. Senator Baucus mentioned it in his opening statement. There are real problems that require real solutions.

I notice when I say "solutions" that there is more than one solution necessary because there is no magic bullet. But one thing that we clearly need to do is to make it easier for Americans to play a more active role in their health care decisions. This should help with the quality of care, as well as just giving basic care.

Health savings accounts are a big part of our move in that direction. In my State in particular, I hear a lot of small business people who want to cover their workers but are finding annual double-digit increases in employee health insurance costs to be very burdensome. Some of these small business owners are already showing an interest in health savings accounts.

Yet, some who are in opposition to health savings accounts refuse to give up the attitude that they have, that only the healthy and the wealthy are going to be able to get into these, or will be trending in that direction.

How do you respond to those critics, and what kind of data do you have, and does the President have, in proposing these measures that will help show that it is benefitting everybody in America, not just the so-called healthy and wealthy?

Secretary SNOW. Mr. Chairman, the HSAs address the twin issues of rising health care costs and availability. They have proven themselves to be a valuable component that helps address both of these issues. Already, some 3 million people have HSAs. Of that 3 million, 1 million are people who did not have insurance before. So, the evidence to date is positive.

There is the argument that they will lead to so-called adverse selection, the healthy and the wealthy will be the beneficiaries. That does not seem to be the case. The evidence is not consistent with that hypothesis.

The data we have shows that, so far—and this data is continuing to come in—42 percent of all the people in these plans have less than $50,000 in earnings, hardly the wealthy; 45 percent are at least 40 years old, and 20 percent are at least 50 years old, hardly the young.

The HSAs are really, in my view, an issue of fairness. Most Americans get their health care, some 85 percent or so who have insurance, through employer-provided plans, which are very tax-advantaged.

An awful lot of people work for small business, are self-employed, and do not have health care, and they buy health care—if they buy health care, if they can afford it—on an after-tax basis, which makes it much more costly to that self-employed person or to that employee who does not have health care but wants health care.

What the HSAs do is make health care available on a basis that eliminates this tax disadvantage to the small business person and to the self-employed. They are not a panacea. We are not suggesting them as a panacea.

But, Mr. Chairman, I think they are proving their value, and we propose to enhance them, make them even more attractive and capable of playing an even bigger role in the health care system.

The CHAIRMAN. I will go to Senator Baucus now. I have a little bit of time left, but I am going to reserve that and go to Senator Baucus.

Senator BAUCUS. Thank you, Mr. Chairman.

Mr. Secretary, when will we need to increase the debt limit?

Secretary SNOW. The letter I sent in December to the Congress, House and Senate, indicated that we will need to raise it by mid-February.

Senator BAUCUS. Do you have any recent data that affects that, those dates, that time?

Secretary SNOW. No, the recent data confirms that that is the time.

Senator BAUCUS. Now, you also say you have a drop-dead date, perhaps, using extraordinary means, some time in March. When in March would that be? What does “drop dead” mean?

Secretary SNOW. Well, it means we have exhausted the capacity.

Senator BAUCUS. But when?

Secretary SNOW. Mid-March.

Senator BAUCUS. Mid-March.

I am just curious. The budget does not reflect, is it not true, AMT costs for 2007? It does not include additional costs for 2007.

Secretary SNOW. We put in the patch for 2006.

Senator BAUCUS. I am talking about 2007.

Secretary SNOW. No, you are right.

Senator BAUCUS. It does not for 2007. So the fiscal 2007 deficit would be higher, actually. Would that not cost, what, about $38 billion per year?

Secretary SNOW. On that order. That is right.

Senator BAUCUS. And Iraq, Afghanistan, for 2007, the supplementals. What will that be?

Secretary SNOW. 2007 has Iraq in, I think, at $50 billion, as I recall it.

Senator BAUCUS. About $50 billion, I think. Right.

And 2008? I am just pointing out that, in a realistic sense, the deficit is probably under-stated. It is probably much greater, given AMT needs, which is a given, and Iraq and Afghanistan supplementals, which always come in in addition to budgets.

With respect to HSAs, my concern, frankly, is the same as with the Social Security private accounts initiative proposed by the President. That is, this emphasis primarily is on an individual deciding for himself what his Social Security account is going to be.

That is moving away from the traditional system where we have a shared solution here. Current employees pay retirement benefits for current retirees. It is a national system. It is a plan. We Americans are all helping each other out.

The assumption behind the President's proposal last year for privatization of Social Security was just the opposite. It is the value that we are not all together, it is everybody out for themselves.

That is my concern about HSAs. It is pretty much, everybody is out for themselves. It is not a shared system, not a shared plan. When everybody is out for themselves, it is usually the bigger and stronger that do better and the weaker do less well.

Anybody can do anything with figures. But it just stands to reason, if you look at HSAs, clearly, particularly with the recommended changes, clearly it is going to help the wealthier and the healthier people in America. It is going to hurt chronically ill Americans. Chronically ill Americans cannot get the benefits of HSAs because they have much higher health care costs.

Rather, if you are younger, you are healthy. Also, if you are also blessed to have some money as a younger, healthier person, this makes great sense. It saves money, and so forth.

But if you are not wealthy and if you have chronic health care needs, as some Americans do, I do not see how this is going to help them. In fact, I see it hurting them due to the principle of adverse selection. Why is that not right?

Secretary SNOW. Well, it is simply, Senator, not consistent with the data that I cited.

Senator BAUCUS. But is it not true that the data, so far, are very incomplete? We do not have any.

Secretary SNOW. Well, there are 3 million people under these plans. One million, we know, did not have health care coverage prior to the HSAs being available. We know it is pretty broadly distributed. We know it has a lot of people who are earning less than $50,000 a year, and we know it has a lot of people who are over 50.

So you just, it seems to me, cannot get away from the fact that there are a lot of people in America today who work for small business or are self-employed who are at a terrible tax disadvantage in acquiring health care.

If we can put them on a par with people who get their health care through an employer system, we do something worthwhile. We lower the cost of health care for them.

If you lower the cost of their getting a policy, it stands to reason those people are going to get policies. There are a lot of middle income, low income people working for small business.

Senator BAUCUS. But why would this also have the effect of encouraging employers to move over into HSAs?

Secretary SNOW. Well, we hope it does encourage many employers, if they do not provide health care, to do it.

Senator BAUCUS. And therefore have the consequence of adverse selection.

Secretary SNOW. Senator, the health care system that we have in the country today functions largely through employers.

Senator BAUCUS. And this will have the effect of discouraging that, undermining that.

Secretary SNOW. I think it will have the counter effect of encouraging many employers, who today cannot afford policies for their employees, to make those policies available.

Senator HATCH. Senator, your time is up.

Senator BAUCUS. Thank you. Just one more point. If there are only 1 million newly-insured HSAs, that means 2 million already had insurance.

Secretary SNOW. And now they have insurance on a lower-cost basis.

Senator BAUCUS. Insurance that has less coverage. Poor insurance. It is insurance with less coverage because they are the healthier and the wealthier.

Secretary SNOW. Well, you are looking at only one dimension here of the compensation package. As somebody who spent years in the private sector, I can tell you the compensation, all-in compensation, is a function of a number of things. Wages, bonuses, cash, is part of it.

Senator BAUCUS. Yes.

Secretary SNOW. But it is also health care benefits, it is pension benefits, it is fringe benefits, it is paid vacations.

Senator BAUCUS. I would like to get into that, but my time has expired. Thank you very much.

Secretary SNOW. All right.

Senator HATCH. Thank you, Senator.

Senator Thomas?

Senator THOMAS. Thank you. Mr. Secretary, a couple of fairly broad notions. You have a vision, as I understand it, in your policies, to recommend an independent commission to study entitlement obligations such as Medicare and Medicaid, and so on. Would you elaborate a little on what your vision is for that Commission?

Secretary SNOW. Thank you, Senator. Yes. As you know, the President, last year, came to the Congress and proposed broad reforms in Social Security to put Social Security, long-term, on a healthier, sounder financial basis. As we look out to the decades ahead, the most pressing problem is Medicare and the unfunded obligations that Medicare presents to the country.

I think the President recognizes that, if we are going to do broad-based reform of the so-called entitlements—Social Security and Medicare—it has to be done on a bipartisan basis.

His call for a bipartisan Commission grows out of his desire to deal with this issue, to put the issue on the table, and continue to press forward to find answers, recognizing that it has to be done in a bipartisan way.

Senator THOMAS. I hope we can pursue that. It just seems like we deal, and I know we have to deal with the yearly issues, but we have to look, it seems to me, a little further in the future. Hopefully that is what we are doing in health care.

It is interesting. We are all very proud of having a private sector system as opposed to a Federal system. On the other hand, we are paying more per capita in this country for health care than anyone else in the world.

So I hope that this whole savings idea can be looked at as a way of fundamental change in our health care system. We are having quite a few systems, however, in savings. We have two or three different ones. We have talked about several of them, whether they be RSAs or ERSAs, or a whole system of savings.

Have you looked at the whole program of savings? Our saving system, as you know, as everybody knows, is down to where, for the first time, we have had the lowest savings of any time in our history, really.

So beyond health care, can we look more at a savings package that is more coordinated? We have several out there that are a little discombobulated. Can we look at a whole savings package together that might help a little bit to change this whole savings thing?

Secretary SNOW. Senator, you put your finger on a very important issue. Savings rates in the United States are too low. Household savings rates are too low. Fortunately, the corporate sector is saving through retained earnings, but the national savings rates need to increase for our own long-term well-being.

The budget calls for a streamlining of the diverse and varied savings vehicles that are almost incomprehensible when you look at them, to try to create a much simplified and more effective form of savings through three vehicles, one called a lifetime savings account, another one called a retirement savings account, and a third one called an employment savings account.

Take the variety of savings accounts, expand the capacity, simplify the rules so that people can understand them better and will have more incentive to put the money in because they are not so restricted in what they can do. I think the proposals embraced in this budget would help change the slope of that line that you put up.

Senator THOMAS. Well, I appreciate that. I, just generally, hope that we can do that. We are looking at, frankly, a society that looks for more and more Federal Government programs. Quite frankly, I think we ought to be looking at fewer.

If we can make some improvements in the concept of individual responsibility as opposed to the government involved in everything in our lives—we talk about doing something with the budget, and at the same time the Ranking Member talks about more Federal programs. Well, you cannot do both. So, I appreciate what you are trying to do. Thank you.

Senator HATCH. Senator Conrad?

Senator CONRAD. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. It is good to have you here.

Secretary SNOW. Thank you very much, Senator Conrad.

Senator CONRAD. Mr. Secretary, when you describe everything, it sounds great. It sounds as though there is no problem anywhere, that everything is steady as she goes.

It reminds me a little of the guy who has his house mortgaged to the hilt, he has charged up every credit card to the maximum, is spending 20 percent more than he is earning, and says everything is great, because that is basically the posture of our country.

The debt is going up dramatically. The deficits are at a record. We are spending between 15 and 20 percent more than we are taking in. Maybe it is useful to hear the other side of the story.

This is what is happening to the debt. There was no mention of that by either the Chairman or yourself. But this is what the debt was at the end of the first year of the Bush administration, $5.8 trillion.

At the end of this year, it is going to be $8.6 trillion, and we are headed in the next 5 years for $12 trillion. So, the debt of the country is skyrocketing, and at the worst possible time, just before the Baby Boomers retire.

Let us go to the next slide. Perhaps most alarming is the amount of this debt that is now being held abroad, being held by foreigners. It is interesting. It took 224 years and 42 Presidents to run up $1 trillion of debt held by foreigners; this President has managed to double that amount—in fact, more than double that amount—in just 5 years. That is an utterly unsustainable course.

Let us go to the next one. The Chairman said the only problem is on the spending side of the equation. No. Deficits result from the imbalance between spending and revenue. You have to look at both sides of the equation. When we go back to 1980, here is the spending line, the red line. Spending has gone up.

The revenue side of the equation has collapsed. Revenue is down, yes, in part because of 9/11, yes, in part because of economic slowdown, but also tax cuts. Tax cuts are a key reason that the revenue side of the equation has collapsed. In fact, revenue last year is the lowest it has been since 1959 as a share of Gross Domestic Product. That is right. That is exactly right.

In terms of the economy, real median household income has declined 4 straight years. That, to me, is not a sign of an economy going in the right direction. That is going in the wrong direction.

Let us go to the next slide. When we talk about the economic recovery, it is interesting to compare this recovery with the other recoveries that have occurred since World War II. What really is striking is how much weaker this recovery is than all the other recoveries have been.

The red line shows what has happened with GDP growth in the average of the nine previous recoveries. The black line is what has happened in this recovery. What we see is 25 percent less growth than the average of all the other recoveries since World War II.

Let us go to the next one, which shows business investment. Business investment is actually 50 percent below what we have seen in the nine previous recoveries since World War II.

Let us look at the job picture, which is next, there. The red dotted line is average of recovery in the nine recessions since World War II. The black line is this recovery. We are 6.8 million private sector jobs behind the other recoveries.

Let us go to the final one. This is the John Snow that I agree with. In 1995, John Snow's balanced Federal budget would benefit Americans in many ways. A balanced Federal budget is the best choice to ensure a bright future for the Nation's economy. I applaud you for that back in 1995.

What has changed? Is it conceivably sustainable for us to be multiplying the debt of the country, the debt of ours held by foreigners? Is it conceivably possible that that is a sustainable course?

Secretary SNOW. Senator, the debt levels of a country are similar in some ways to the debt levels of a household. The ability to service the debt is a function of the size of the business enterprise's cash flows or the size of the family's earnings. For a country, it is a function of the size of the GDP, the total output that we are capable of producing.

Our debt, as a fraction of GDP, is at levels that are low by historic standards, around the historic average of 40 percent. We are going to come down over the budget cycle, very low by comparison with other countries, like in the G–7, the industrialized countries of the world.

I think there is no doubt that, given the deep and liquid capital markets of the United States, we will continue to attract capital from U.S. investors and from investors around the world. They invest in our markets because they get the best risk-adjusted returns in those markets.

Senator HATCH. Senator Kyl, you are next.

Senator KYL. Mr. Secretary, thank you for putting these figures into proper perspective.

According to the information that I have, and from CBO, the average revenue since World War II is 17.9 percent. In other words, the share of the economy that the Federal Government collects in taxes, as a percent of the GDP.

CBO projects that the share of the economy revenue will grow from 17.7 percent of GDP in 2006 to 18 percent of GDP in 2010. Is that your understanding of the figures?

Secretary SNOW. Yes, it is.

Senator KYL. So that we are almost exactly at the average of revenue collected in taxes as a percent of GDP in this next fiscal year.

Secretary SNOW. That is correct, Senator.

Senator KYL. Except for the spike in increased spending caused by the hurricanes and the necessity of funding the wars in Afghanistan and Iraq, where would we be in terms of revenue collection as a percent of GDP, at least in rough terms?

Secretary SNOW. The revenue collection, I think, is forecasted at about 17.6, 17.7 percent, rising to that 17.9, 18 percent that you cited.

Senator KYL. And that revenue collection will continue, so that if spending can be reduced, we would be well above the percent that has been the average since World War II. Is that correct?

Secretary SNOW. Yes. Yes, Senator. In fact, if you take those numbers out and do not have the tax reductions made permanent, you are going to rise to 20 percent, which takes you over the historic average.

Senator KYL. Exactly. So it is important for us to look at the spending side of the equation.

Now, just remind us, very briefly, with respect to discretionary spending, what the President's budget calls for for this coming year.

Secretary SNOW. For non-security, non-defense spending, it is flat with last year. It is down in real terms by inflation.

Senator KYL. Exactly. And is that roughly about a third of all of our expenditures?

Secretary SNOW. Yes.

Senator KYL. All right. So the real challenge here is to try to find a way to get a handle on the non-discretionary, or entitlement, spending. What does the budget call for in that regard?

Secretary SNOW. The budget seeks to hold overall spending at the rate of inflation.

Senator KYL. And the President tried to do that last year. He called for a certain amount of restraint on spending. Do you recall what last year's budget called for?

Secretary SNOW. Yes. I think last year's budget called for overall spending not to exceed inflation.

Senator KYL. But was the entitlement spending reduction against projected revenues not something on the order of $65 billion?

Secretary SNOW. I think the proposal in the budget was $65 billion.

Senator KYL. It was $65 billion, as I recall.

We ended up accomplishing a little less than $40 billion as I recall. Is that correct?

Secretary SNOW. That is right. That is right.

Senator KYL. So with respect to the chart that has the President's picture on it, maybe it ought to have Congress' picture on it, I guess is what I am saying here, because the President would have held the budget deficit to a much lower level, but Congress could not muster the courage to generate a little less than $40 billion over a 5-year period. I just want to make it clear. You do not have to respond to that.

But I think it is not helpful to politicize this issue to such an extent that we show the President's picture as if he is the dictator of the country, and he is the one that spent all of the money, when in fact Congress had a great opportunity to achieve greater savings and failed to do so.

Just in the last few seconds that I have, remind us again why it is important for us to extend the current rates that we tax capital gains and dividends at, which are set to expire in 2008?

Secretary SNOW. Well, because they are important to keep the economy growing. Those statistics I cited earlier about growth in the economy relate directly to the fact that Congress, back in 2003, reduced capital gains and reduced dividends.

Senator KYL. If I could just interrupt. What would happen if we did not extend them? What has the market already assumed?

Secretary SNOW. Well, I think the market today credits Congress with the good sense that those tax reductions will stay in effect. If they do not, then of course that is a tax increase. If we have a tax increase, I think we would see a reversal of much of the positive things we have seen.

The equity markets are up some 40 percent since those reductions were put in effect, many more companies are paying dividends today, and the dividends that are being paid are much higher. That helps corporate governance.

When I remember my days in corporate life, the CEOs often said to the shareholders at the shareholder meeting, when asked to pay higher dividends, well, we cannot do that, that is a tax-disadvantaged way to reward shareholders.

I think what was accomplished through the dividends reductions, capital gains reductions, has helped corporate governance. It has improved capital formation. We have seen 10 straight quarters, Senator, of increased capital spending after a period where you had 9 straight quarters where capital spending was down. The equity market is stronger, and so on.

The 4.7 million jobs came because businesses invested. When you lower returns on taxes on capital, good things happen. Returns on capital rise, businesses invest. As they invest, businesses expand, and then they need more workers. It is the virtuous cycle we have seen play out over the last 2½ years.

Senator HATCH. Senator Wyden is next, then Senator Schumer will follow Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Secretary, the current tax system is a paperwork nightmare for millions of Americans, and it discriminates against people who work for a wage.

Now, I want to change this in a bipartisan way. It will be a lot easier to get that done if the administration will come off the sidelines and join the effort.

I would like to start by asking you to say, why can we not begin immediately to work in a bipartisan way to simplify the tax code? For example, in my legislation, S. 1927, the Fair Flat Tax Act, I have a one-page 1040 form. It is kind of a revolution, because I could fill it out myself, and it has been a long time since any of us on the Finance Committee could fill out a tax form.

Why can we not begin, right now, on the simplification effort to jump-start this whole reform? As you know, there have been 14,000 changes to the tax code. It comes to three every day for the last 20 years.

We are going to spend $140 billion this year complying with the code. It is more than the government spends on higher education. Why can the administration not join with all of us on this committee to begin immediately the simplification part of tax reform?

Secretary SNOW. Well, Senator, I applaud simplification, and applaud you for entering the fray with your legislation.

We received the results of the Tax Panel report and their year-long work late last year. This is the panel chaired by some of your former colleagues, Senator Breaux, who used to sit next to you there. Senator Connie Mack of Florida chaired it and Senator Breaux was the vice chair.

They did a terrific job, I think, of looking at the code and trying to consider what changes might make sense, including a lot of proposals for simplification, with a page that looks not too different than yours, I think.

Senator WYDEN. Mr. Secretary, let me just interrupt, because that is why I think we can get going now. I have met with Senator Breaux. I have a one-page 1040 form. The Commission's, for example, is a little longer. But for government work, they are about the same.

Why can we not get going, though, and not wait 2 years for this effort? We have a bipartisan group on this committee, Senator Baucus, Chairman Grassley. We can get to work on this and make progress.

Secretary SNOW. You get a chance to do tax reform, as I look at it—and we are in one of those periods—if you look back over the record, about once every 20 years. JFK had far-reaching, broad-based tax reform initiatives, then Ronald Reagan, 20 years later. Now we have a chance with this President, who has said he is committed to broad-based reform. There is no doubt about the fact where the President stands. He wants a simpler, fairer tax system.

We at Treasury now have the results of the panel and I commit to you, Senator, we are working hard to come up with——

Senator WYDEN. When would you think we could actually start, Mr. Secretary? I mean, people all over this country are getting their 1099s, their W–2s. They're shouting across the living room, "Honey, can you find that receipt from the copier that we bought March of last year?" They want to know why we cannot begin this. When do you think we can start?

Secretary SNOW. Senator, as soon as possible. I have the same experience you do. I have traveled the country, and everywhere I go I hear all sorts of things from people. I have never heard one person say, Mr. Secretary, keep the code just the way it is, we love every word of it. I have never heard anybody say that to me.

In fact, their sentiments are more like yours and more like the other members of the panel. It is time to fix it. We agree with that. We want to do it right, and we are hard at work to give the President recommendations that I hope you will be able to see and work on in the not-too-distant future.

Senator WYDEN. Let me see if I can get one other question in, again, to jump-start this. My proposal has three brackets, 15, 25, and 35. The Commission has four brackets. So, again, we have an opportunity to come together.

But the one area that I think is going to be toughest is, we have to close the gap between the treatment of those who work for wages and those who make their money from investment. How would you propose doing that?

Secretary SNOW. Senator, I agree with you, it is a serious subject. It is one that we are looking at hard. I think it is best for me to refrain from offering thoughts on that until we pull together our total package and are in a position to present it to the President. But I would very much look forward to joining with you in a discussion on that, and the whole range of issues that the tax code presents.

Senator HATCH. Your time is up, Senator.

Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Thank you, Mr. Secretary, for coming here to share your views on the President's budget proposal.

I have reviewed the major proposals. One thing that stands out to me, is this. The President's ideology puts him in a straightjacket. The budget makes one thing clear: you cannot be an ideological conservative and be compassionate at the same time.

I would make four brief points about this. There are nearly $2 trillion in additional tax cuts, but most of it is geared to the very well-to-do, people whose income is over $1 million, rather than the middle class who are finding it harder and harder to make ends meet with rising health care, tuition, and energy costs.

Dividend and capital gains cuts take precedence over reducing the AMT, which hurts people whose income is between $67,000 and $200,000 a year.

Second, programs that decimate the needy and middle class, such as cutting student loans—a hard one to believe—in the guise of making courageous choices, when in reality a courageous budget would have cuts for the bigger interests, big oil, corporate America, and others who do very well here.

Third, there is a lot of fanfare for new programs, energy independence, more money for math and science teachers, but so few dollars are dedicated to them that these necessary new initiatives amount to all hat and no cattle.

Last, but not least, more and more debt. By the end of his second term, President Bush will have presided over a near doubling of the birth tax or the amount of publicly held debt owed by every man, woman and child.

If we were to completely eliminate all non-defense discretionary spending, zero dollars for education, veterans, transportation, et cetera, there would still be a significant deficit.

So I have a great deal of problems with this budget, as is apparent. I would like to ask questions on each of them. I will have to get to some on the second round, but let me get to my first problem.

We do not have the ability to do unlimited tax cutting here. The choice that we seem to face is between the capital gains and dividends cuts, extending those, which the President's budget proposes, or reducing the Alternative Minimum Tax, which is really a dagger pointed to the heart of the middle class and the upper middle class in America.

Assuming that we do not have the ability to do both, to fully fund both, why does the administration choose as its priority capital gains and dividends over the AMT? Assuming you would like to do both, assuming we would all like to do both?

Second, if you face the choice, why does the budget choose capital gains? You do choose it, so I do not want to ask you what you would choose. Just give me an explanation for that.

Secretary SNOW. Well, Senator, first of all, I will confirm these numbers with you, but I think that the lower tax rates on dividends and capital gains more broadly benefit average Americans than AMT relief.

I will confirm these numbers with you. Something like over 40 percent of the taxpayers with income below, I think it is $50,000, report income from dividends or capital gains.

Senator SCHUMER. No. As I understand it, while lots of those people get dividends and capital gains, the overwhelming majority of those dividends and capital gains are tax-free already because they are in IRAs and other kinds of retirement. Mutual funds, et cetera.

So, people below $50,000 do not benefit very much from a reduction. As I understand it, the majority of the capital gains and dividend cuts go to people whose income is over $1 million a year.

Secretary SNOW. Senator, we are talking about the number of people——

Senator SCHUMER. Well, no. Let us talk about the dollars.

Secretary SNOW. The number of people affected. It is just remarkable how many households of moderate income benefit from the equity market. I think it is over half of the American households.

Senator ROCKEFELLER. Sir, answer his question.

Secretary SNOW. I did. Over half of the American households.

Senator SCHUMER. But they do not pay tax on it, sir. They do not pay tax, now, on it. They do not need this reduction. It is only people who have dividend and tax income apart from mutual funds, and particularly apart from retirement accounts, who pay it.

Senator HATCH. Senator, your time is up.

Secretary SNOW. Yes. Senator, in addition to what I said, of course, as I pointed out earlier in response to Senator Kyl's question and Senator Thomas's question, the lower tax rates on dividends and capital gains are at the heart of this very strong recovery we have seen, which has produced capital spending being up for 10 straight quarters, job creation for 10 straight quarters, GDP growth at about 4 percent for 10 straight quarters, and an economy that is performing very, very well.

Senator SCHUMER. Mr. Chairman, my time has expired. I would just ask unanimous consent that the Secretary submit to us what percentage of taxpayers below $50,000 pays taxes on dividends and capital gains, and how much. Is that all right, Mr. Secretary?

Secretary SNOW. Yes.

Senator SCHUMER. Thank you.

Senator HATCH. Senator Bunning?

Senator BUNNING. Let me enter into this. Thank you, Mr. Chairman.

Anyone who owns mutual funds outside of a retirement plan pays on capital gains, everyone that owns mutual funds, because you are required to pay taxes on capital gains if you are in a mutual fund, just like any other ordinary income. Believe me, it is significant.

I would like to get your thoughts on a couple of issues, Mr. Secretary. In 2004, CBO estimated that capital gains tax liabilities—

tax liabilities—for 2004 and 2005 would be $98 billion, a $27 billion decrease from earlier projections made for those 2 years.

When we look at CBO's most recent report, it shows payments from capital gains taxes were $151 billion for 2004 and 2005, significantly higher than CBO estimated this time last year.

I understand that when Congress cut capital gains taxes in 1997, actual 1997 and 1998 capital gains revenues were about 11 percent higher than the original CBO estimates. Would you please comment on this?

Secretary SNOW. Yes. Yes, Senator. My comment is that both CBO, and Treasury, to some extent, under-estimated the power of those capital gains and dividends tax reductions in terms of what they would do to the revenue stream of the United States.

I think the numbers you cite are the ones we know. What they indicate is that, as you get the economy performing well, as you get equity markets doing better, as we have seen in the wake of these tax reductions, it produces its own stream of revenues.

We, as part of this budget, are establishing, in the Office of Tax Analysis, a capacity to get at that question more precisely by doing dynamic analysis of tax reductions to see how they affect GDP growth, and that prepares the way for us to look at macroeconomic variables and determine what effect that will have on Federal revenues. We need to do a better job of that.

Senator BUNNING. Do you know who was in control of the Congress when AMT was created as a tax?

Secretary SNOW. Yes.

Senator BUNNING. What party was controlling the House and the Senate at the time?

Secretary SNOW. I think it was 1969. Yes.

Senator BUNNING. Thank you. You are just answering the significant year.

In the CBO report we received a few weeks ago, it was mentioned that the temporary rate decrease on overseas earnings brought back into the United States during 2005 had a marked increase on tax revenues.

I am asking you the question, knowing the answer, can you tell us how much in additional capital is estimated to have been brought back into the United States as a result of this temporary provision?

Secretary SNOW. I think it is something on the order of $300 billion.

Senator BUNNING. It is $340 billion, to be exact.

And do you know what that means to the revenue stream at 5.25 percent in taxes for the United States that would not have been brought back? It means $18 billion additional of revenue for the United States with just that 1-year window of a temporary provision. Think if we could do it for another year or two. That money has to be reinvested in jobs and capital here in the United States.

Mr. Chairman, I have an opening statement I would like put into the record, if you do not mind.

Senator HATCH. Without objection.

Senator BUNNING. And I will yield back.

Senator HATCH. Thank you.

[The prepared statement of Senator Bunning appears in the appendix.]

Senator HATCH. Senator Bingaman?

Senator BINGAMAN. Thank you very much, Mr. Chairman. Thank you, Mr. Secretary, for coming and giving us your views today.

Let me ask about another of the economic issues that I am concerned about. I think Senator Conrad expressed some of my concerns pretty well about the budget deficit. I guess I am also concerned, though, about the trade deficit, and we have not talked about that yet this morning.

I have two charts I want to show you, and then I will ask you a question.

Secretary SNOW. All right. Good.

Senator BINGAMAN. This first chart is the current account deficit as a percentage of Gross Domestic Product. You can see that, at the current time, it is over 6 percent.

Now, as far as I can tell, the only time in our country's history that it has been over 4 percent, let alone 6 percent, was right after the War of 1812 when we were flooded with imports. Now it is over 6 percent. That concerns me.

Let me show you a second chart. This second chart relates to our trade imbalance with China. As you can see, the first year of this administration, or to take 2000, it was $84 billion. This last year, it is $200 billion, give or take. Again, that concerns me. The estimate I have is that the overall current account deficit will exceed $800 billion in 2006.

My concern on this is, I do not see a plan to deal with this on the part of the administration. The head of the IMF, the managing director of the International Monetary Fund, said recently that he was very concerned about the record shortfall in the U.S. trade account.

It could result in an abrupt slow-down in U.S. consumer spending, a falling dollar. He said it is important to abandon the pretense that global imbalances do not matter and will cure themselves.

He cites two things that need to be done. First, he says, when he looked at government action, we need to deal with U.S. fiscal policy, and that is the issue we have been discussing where you say everything is fine, but I disagree strongly. The other issue he cites is exchange rate and structural policies in Asia.

Now, various people, both Democrat and Republican, have been saying that we cannot continue to see the increase in our trade imbalance with China year after year after year without some change. We were trying to get them to float their currency. They changed it 2 percent, I believe, and everybody backed off.

But what is the administration's plan for dealing with this unsustainable situation?

Secretary SNOW. Senator, the problem you are talking about is extraordinary complex. The solution to it is a shared responsibility on the part of all of the major participants in the global economy.

The fundamental problem is the fact that the U.S. is generating so many investment opportunities that exceed our own domestic savings. Now we need to deal with our low savings rates. We have talked about that.

We deal with that by bringing down the deficit, which the President's budget proposal will do. It will bring it down to a level that is low by historical standards. The budget brings the deficit down to below 2 percent of GDP.

Senator BINGAMAN. But this is 2009. You do not dispute that, in the rest of the 10-year period, it goes way, way back up again as soon as you folks leave office.

Secretary SNOW. Well, where it really goes up is the decade after that.

Senator BINGAMAN. Well, at any rate, any long-term projection of the deficit is bad.

Secretary SNOW. I agree with you. But the long-term problem, the 20s, 30s, and 40s, comes from these unfunded mandates. We need to get at that. That is why the President suggested the bipartisan Commission. So, we need to work on our savings. We have proposals to reduce our budget deficit, reduce the dissavings in the government, but also to encourage the savings, the dialogue I had with Senator Thomas.

But, Senator, it is awfully important that in other parts of the world that are growing so slowly, Europe and Japan particularly, that they address their slow growth rates, because their slow growth rates are limiting the ability of those economies to generate disposable income to buy from us, which is why, when the President talks at the G–8 summits, he is always putting a focus on the rest of the world taking steps to improve the performance of their economies.

The third piece of this—you put your finger on it—is greater flexibility in exchange rates where they are rigid today, or too rigid, and do not reflect underlying market forces.

I hope Mr. Durato, the head of the IMF, as he talks to us about our need to improve our savings posture, will make the case to countries who have rigid exchange rates to move to greater flexibility, because that is a big part of the problem, too.

Senator HATCH. Senator Jeffords?

Senator JEFFORDS. Mr. Secretary, you have made clear that the administration does not want to increase taxes. But you would not know that, from looking at the agricultural budget. The administration is proposing a whole new tax on dairy farmers.

I can tell you that in my State, these are struggling small businesses. The idea that they should shoulder higher taxes is lunacy. Can you tell me why the administration wants to cut taxes for wealthy investors, while increasing them on family farms?

Secretary SNOW. Senator, I do not have a clear understanding of what the proposals are in the budget as they relate to dairy farms, but I will look into that and get back to you.

You are right that the administration's overall point of view is that we should sustain a low-tax environment on American businesses and on capital formation, because the record is pretty clear that it works. It has led to the creation of lots of jobs. It has led to a very low unemployment rate and general prosperity in the country.

But I do not have the answer to your question. I will look into it and get back to you.

Senator JEFFORDS. I certainly would appreciate that.

Secretary SNOW. Thank you.

Senator JEFFORDS. Mr. Secretary, the deficit in 2004 was $413 billion, and the deficit this year is projected at $423 billion. Granted, we have seen a pattern of these estimates being on the high side, but do you really see this as progress?

Secretary SNOW. Well, the deficit is going to be up this year, unfortunately, reflecting the commitment that the Congress has and the President has to help deal with the victims of Katrina, the largest natural disaster our country has faced. That adds a considerable amount to this year's deficit.

But getting beyond 2007 to 2008, 2009, you see the deficit coming down and, as I say, getting down below 2 percent, getting down to levels that are low by historical patterns.

Seeing the deficit go up is regrettable this year. It interrupts the nice path, the nice downward path, we were on. But I think we have an obligation to, as the Congress does, to deal with the victims of Katrina and those communities.

Senator JEFFORDS. The President has expressed his concern about entitlements, and I certainly agree on the need to control such spending. But one of the fastest-growing entitlements is debt service, yet we hear little or nothing about that.

Will the budget the President has submitted increase or decrease the deficit over the next 5 and 10 years, and if so, by how much?

Secretary SNOW. The debt is rising, as we have talked about. The debt held by the public is still low by historical standards as a fraction of GDP, but it is rising, therefore, the service on it is rising. But it still, Senator, will be relatively low by historic standards because interest rates are low.

We are blessed with low inflation and low interest rates. That is helping to keep the net interest costs to the Federal Government down. But the debt is rising. It will, you are right, be rising.

Senator JEFFORDS. Thank you. I would hope you would take a look at our dairy farmers' problem.

Secretary SNOW. Senator, I promise to do that and get back to you.

Senator JEFFORDS. Thank you.

Senator HATCH. Senator Lott?

Senator LOTT. Thank you, Senator Hatch, our acting Chairman, for this recognition.

Let me just say to you, Mr. Secretary, thank you for being here again. Thank you for your leadership. I have followed your activities over the past 3 years and have been very proud of your efforts to provide leadership as the Secretary of the Treasury, and with the results.

I think that your efforts and what has happened with the economy has not gotten the attention that it deserves, so I am glad to be with you and to have you here today with us.

I am particularly interested in the small business expensing provision. I have been down at another hearing, and I am not sure exactly what you have been asked, but I think this is a critical area.

It is one of the areas where we put some incentives in the Katrina tax bill that now, as people have looked at it, they are very pleased with that opportunity. I think it is already having a positive effect on the future in the Katrina-devastated area in my State, and hopefully in Louisiana, too.

Now, the proposal doubles the amount a small business can expense to $200,000 per year, and it increases the allowable investment before the $200,000 limit begins to phase out.

Now, you are talking about how important this is as we look to act on things that will help the economy. I would like for you to comment a little bit more on what you are proposing here and the likely effect it will have on jobs creation and economic growth.

Secretary SNOW. Senator, thank you. Thank you very much. The 2003 tax legislation contained a provision, under section 179, to raise the allowable investment from $25,000 to $100,000.

We have seen a lot of jobs created by small business and by suppliers to small business as a result of the expanded spending that that provision gave rise to. I think it has played a critical part in the job picture we have seen.

Two jobs out of three get created by small businesses. This provision creates an incentive for small businesses to invest. When they invest, they have more capital and they want to hire. We have seen that happen.

Now, what we are proposing here is to take it even further, to double it, to go from $100,000 to $200,000.

Senator LOTT. Which is what we did in the Katrina tax cuts.

Secretary SNOW. Which is what you did in Katrina. We think that it is helping in Katrina, helping in rebuilding businesses there, and it would be a good boost for the overall economy. We want to help small business.

Small business really is the engine of growth. This will create incentives for small business to expand, to grow, and to hire. It is part of the President's overall commitment to keep the economy on the right path.

Senator LOTT. We argue here about the impact of these different proposals, but one of the ways for that deficit to be controlled and not be as high as is projected is to have growth in the economy. There is no question that Katrina has added $100 billion to spending. You can extrapolate that right to the deficit we are dealing with.

Now, certainly, under extraordinary circumstances, things like that, you have to accept them, because we have an obligation there. There was no way we could recover without it. Louisiana is going to have a tough time getting through their problems, even with it.

But what would be the effect if we do not extend these tax cuts we have in place? I mean, it is a huge tax increase. And, by the way, people act on the anticipation of what is going to be available. If they think, well, it is not going to be there, they are going to start making decisions on that possibility.

Would you just comment on that in the remaining time?

Secretary SNOW. Senator, one important aspect of a well-functioning tax code is certainty, so people can plan for the future. I think the market anticipates that those reductions on capital gains and dividends will be made available. If Congress fails to do that, fails to extend, then we have a tax increase.

Senator LOTT. Let me just interject there. I went up to New York and met with a lot of these executives. I was stunned by the very matter-of-fact assumption that, yes, that is going to continue, that is going to be in place. I said, "Why do you think so?" Basically their attitude was, they could not contemplate the contrary. The impact, if we did not do that, would have an immediate, precipitous, negative effect, I would think.

Secretary SNOW. I think it would, very much so. I think the charts we put up showed that we have had 10 consecutive quarters of increased capital spending, in part because of the lower dividends and lower capital gains that have been put into effect that create an incentive for people to invest. We should not remove that incentive from our economy, Senator.

Senator LOTT. Thank you very much, Mr. Secretary.

Secretary SNOW. Thank you.

Senator HATCH. Thank you, Senator Lott.

It is now my turn. Welcome back to the Finance Committee, Mr. Secretary. It is good to see you again.

Secretary SNOW. Thank you, Senator.

Senator HATCH. We have on the floor right now, and will have a cloture vote on even the motion to proceed, the asbestos reform bill. As you know, there have been reports that up to 90 percent of those cases are frivolous and that there have been tremendous recoveries that really were unjustified, while the mesothelioma victims go without compensation, and many of the lung victims go without compensation.

How would it affect the economy if we can proceed with that bill and finally get something done there? It is a $140 billion trust fund that is way higher than anybody thought it would be. But how would that affect the economy?

Secretary SNOW. Senator, I think it would be positive. I applaud you, Senator Lott, and others for your efforts on that legislation. It removes a big uncertainty. When you remove uncertainties, you create a more positive environment for businesses to go forward. I think it would be very positive on the economy. I hope that legislation will carry.

Senator HATCH. Well, thank you. I found it fascinating that Federal revenues grew at a rate of nearly 15 percent last year, which is the highest rate of growth since the early 1970s.

Maybe in real terms, since we have been keeping track—and it is a tremendous result, and you have explained to what you attribute this tremendous growth, and I agree with you—revenue projections for the current fiscal year are anticipated roughly around 6 percent, which is still good, still very impressive, and then slowing a bit in subsequent years.

Why do you say the revenue growth is slowing, and what can we do to increase it while keeping our economic growth intact? You have skirted this issue pretty well.

Secretary SNOW. Yes, Senator. The economy is getting closer and closer over that budget cycle as we get out into 2007, 2008, 2009 to what the economists call the full employment level, where all the available resources are employed, plant capacity goes up to the level that there is not a lot of extra plant capacity, and the unemployment rate falls so that people who are looking for a job, and cannot find one, can find a job.

Then, since we are not bringing more resources into the economy, the economy's ability to grow faster slows down. As that happens, we get back to a rate of growth, I think, of 3.1 percent in those out years, which economists say is their estimate of the point at which you have full employment without inflation.

Well, if the economy slows down, then we would see some reduction in the receipts to the Federal Government. That is basically what we are talking about there. But it is still a good growth rate, that 3 percent. It is a rate consistent with non-inflation, full employment

Senator HATCH. I have seen years when we would have loved to have had that growth rate.

Let me just ask you two separate questions, then you can answer them. Can you explain what has happened with the revenue collected for dividends and capital gains since 2001? Did the tax rate reduction on dividends and capital gains of 2003 have a serious impact on the revenue collected on these items?

If we allow the lower rate to expire as scheduled, can we expect to see a large increase in revenue from dividends and capital gains? That is all one question, but a bunch of questions within the one.

The second thing I would like to ask you about is, of the total budget deterioration since 2001, to what extent was it caused by the 2001 recession and the subsequent halting recovery? How much was caused by the tax cuts and how much by the build-up in military and homeland security spending, in rough terms? We are talking about budget deterioration.

Secretary SNOW. Yes. Senator, I will get you a precise answer. It is roughly about a third, a third, a third, although I think it is weighted more heavily to the recession and to the collapse of the equity markets, because what happened is, the government's revenue stream, as was shown on one of those charts, came dramatically down with the collapse of the bubble, which took $7 trillion out of the equity markets.

Those booming equity markets had created a lot of capital gains and a lot of taxation on options that just disappeared. The revenue stream went from something like 21 percent of GDP down to 15.5 or 15.6 with the recession and with the collapse of the market. So, that, I think, was the single biggest part of it.

Then we had 9/11 and homeland security, which increased spending. The tax cuts, I think, of the three, are the smallest part. I will get you a precise answer. But the tax cuts were essentially to get the economy going, to get the revenue stream rising up. Now we see the revenue stream rising back up towards its historic levels. The tax cuts were critical to get people back to work and get businesses investing.

Senator HATCH. Well, thank you. My time is up.

Senator Snowe, we will turn to you.

Senator SNOWE. Thank you.

Welcome, Mr. Secretary. In response to Senator Lott, in terms of certainty, stability, predictability and extending the tax cuts, and specifically the capital gains and the dividends, because otherwise we will cause a tax increase in 2009, 2010, 2011, could we not say the same would be true with respect to the Alternative Minimum Tax? I am really concerned that there has been little or no attention, essentially, focused on this issue that has a profound impact on middle America.

So when we are talking about extending the tax cuts of 2001, I think we also have to consider, what are our priorities and the timing of various issues, given the impact it is going to have on our revenues, obviously.

Many of those tax cuts were critically important, but just to extend them will essentially capture 30 million Americans under the AMT. If you allow it to lapse, it will capture 17 million. So, clearly, this is a major issue that has to be addressed. I am surprised that we are talking about just the capital gains and dividends. Unfortunately, the Senate is in a position this year—the whole Congress, rather—in looking at that question, we have allowed AMT to expire.

So is it not a tax increase on middle America year to year, because this is a yearly extension as opposed to looking at two specific provisions that do not expire in 2009 and 2010—then we are talking about other tax cuts that do not expire until 2010—rather than concentrating on one of the biggest taxes on middle-income America that probably could do more to generate growth in this economy than anything else?

Secretary SNOW. Well, Senator, we will be addressing the AMT. The AMT is such an integral part of the American tax system, such a fundamental part of our code, that it needs to be addressed, we think, in the context of broad-based tax reform.

The tax panel that I mentioned that reported in to us, chaired by Senator Mack and Senator Breaux, had one approach to the AMT, to have a fix on the AMT. We clearly are going to want to have a fix, not a patch.

We propose a patch for this year, but we need a real fix for it. But the fix has to be in the context of broad-based tax reform. I pledge to you, that is how we will address it.

This is catching more and more people every year because the AMT was never indexed for inflation. As a result, it reaches out every year and grabs the sorts of numbers you were talking about.

At some point, it will be tens of millions of people ensnared in this alternative tax system, the dual tax system, and we intend to find an answer for that, but to do so in the context of broad-based tax reform.

Senator SNOWE. Well, you see, I guess I am not clear in terms of why it would not create as much uncertainty with middle-income taxpayers and what it portends for the future. It is detrimental. It is devastating, as a matter of fact. I think it is putting the cart before the horse.

In many instances, in looking at the context, why are we not considering all of this as opposed to assigning $1.4 trillion additional revenues in the future, given all that we are expected to face with the Baby Boomers' retirement beginning this year, for example, and the impact on entitlement, the growth of entitlement spending, and of course what we have on the tax side, if we are going to use those revenues for that purpose to the exclusion of looking at the Alternative Minimum Tax, which is the greatest tax on middle-income America? You see, I just do not understand. I think it is putting the cart before the horse.

Secretary SNOW. Well, Senator, it is being addressed, I can tell you that right now. We are looking at it. I talked with Senator Wyden earlier about our interest in working with him and others who want to pursue broad-based tax reform, and an AMT fix will be part of our broad-based tax reform.

Senator SNOWE. Well, I think it should be included in all that we are considering, because we only have so much revenue, in the final analysis, given the trajectory of the rising deficits.

I think that is the issue here that we have to focus on, what is absolutely essential and what will motivate the economy. Clearly, reducing marginal tax rates and addressing the Alternative Minimum Tax for middle-income America is one of them.

I think, certainly, we need to do that, given the fact that even savings rates have gone down. It has been one of the lowest rates since before World War II.

Thank you, Mr. Chairman. Thank you, Mr. Secretary.

Senator HATCH. Senator Lincoln? Then I am glad to turn this back to Senator Grassley.

Senator LINCOLN. Thank you, Mr. Chairman.

Welcome, Mr. Secretary. Just to follow up on Senator Snowe's question. So basically you are saying to us that, whether it is the expansion of the Child Tax Credit or the AMT relief, that those are appropriately reviewed in overall tax reform, but the extension of the other taxes that do not actually expire until 2009 anyway do not need to be taken up then?

Secretary SNOW. No. What I am saying is, I hope the Congress will move now on the dividends and the capital gains. I think it would send a terrible message not to.

Senator LINCOLN. Well, why is it different that we should take those up immediately? You are advocating, or the President's budget is advocating, permanent extension of many of those 2001–2003 tax cuts that are contained in his budget.

Secretary SNOW. Right. Right.

Senator LINCOLN. So you are making that a permanent extension, not to be reviewed in this tax reform that we are talking about to be so essential in dealing with the ideas of Child Tax Credit expansion and AMT?

Secretary SNOW. What we are proposing on dividends——

Senator LINCOLN. Which is permanency?

Secretary SNOW. Yes. Because we, I think, have seen the positive results of that. We know it works. We know lowering the cost of capital encourages capital formation, helps stimulate——

Senator LINCOLN. Well, both the past CBO Director, and I think the current Acting Director, have commented that, regardless of one's views on the pro-growth nature of these cuts that you are advocating, it is not even close to accurate to say that the cuts will pay for themselves.

Secretary SNOW. No, and we are not arguing that.

Senator LINCOLN. Well, if the revenue stream is so high, why are we in such large debt? Why is there the incredible debt that we have here? Do we not believe in any kind of pay-go?

Secretary SNOW. Well, the debt is made up of two components, the debt held by the public, which basically reflects the annual deficits——

Senator LINCOLN. I am talking about the debt we owe China.

Secretary SNOW. But that will come down.

Senator LINCOLN. Why is that?

Secretary SNOW. Well, because of the sort of spending restraints that the President has called for in the budget, along with——

Senator LINCOLN. That goes to, kind of, my next question, that the President does call for tremendous sacrifices in his budget. I guess you explained that agencies were asked to make very tough decisions in accordance with the President's dedication to fiscal discipline.

I certainly applaud the President's new-found belief that we need to be paying for government spending and not borrowing from foreign countries. I find it more and more difficult that we are negotiating trade agreements with our bankers, now. I think it is going to get even harder.

But it seems that most of the ideas for fiscal discipline that are being promoted by the administration come in the form of cuts to social programs that working families really need.

I guess my focus is really on children, Mr. Secretary, when we see the largest reduction in spending on education in 26 years, and we are talking about Child Tax Credits for working families.

At a time, I guess, when so many of our citizens—particularly our most vulnerable, the elderly—are depending on Medicare, and we are going through a real crisis now with our prescription drug Part D, which obviously did not get any additional funding there—I guess what I would like to know is, what sacrifice is the administration asking of those Americans at the higher incomes? Is that reflected in the budget as well?

Secretary SNOW. Senator, this budget is one designed to put us on a path that will bring the deficit to levels that are low by historical standards.

Senator LINCOLN. Is that why long-term bonds are returning less than short-term bonds?

Secretary SNOW. The current interest rates on Treasury paper are low by historical standards, and that is a positive thing. We should be happy.

Senator LINCOLN. For short-term.

Secretary SNOW. Well, both short-term and long-term. Interest rates are down, reflecting low—by historical standards—anticipated inflation, and I think, good monetary policy, good economic policy overall. That is something we should be pleased about. I think that situation will continue.

Senator LINCOLN. Are those sacrifices that the higher-income earners are going to be making? Is there something there that I am missing in the question I have asked?

If we are seeing the lowest investment in education for our future leaders of this country, and in terms of Child Tax Credits and making sure that we provide it to all of our lower-income workers, without an income increase and the fact that we have not de-indexed the amount on the Child Tax Credit, we have a real concern there.

Secretary SNOW. Senator, I think if you look at the safety net, you will see the safety net is in good repair and is strong. The best thing you can do for people is to make sure that we have a good economy that creates jobs.

Senator LINCOLN. Absolutely.

Secretary SNOW. The best thing for the American family is to make sure that there is opportunity, and opportunity in jobs. I think that is the focal point of this.

Senator LINCOLN. But the Bureau of Labor Statistics tells us that incomes are continuing to fall further and further behind the cost of living. With the jobs that are being created, with a stagnant income, working families are not going to be able to contribute to the economy like we want them to. And I do not know. I just do not think that the ultra-wealthy can carry the whole burden of keeping our economy great.

Secretary SNOW. Well, Senator, our economy benefits from people in all the income categories.

Senator LINCOLN. Sure.

Secretary SNOW. On this question you are getting at, of fairness, it is important to note that, after the tax cuts went into effect, the highest-income people in the United States are now paying a larger share of the total tax burden than they did before the tax cuts went into effect.

That is because of things like the 10-percent category, the child credits, the refundable child credit, and so on, as well as the fact that the reductions in the tax rates were greater for people in the lower-income categories than the higher-income categories.

So asking about sacrifice, I do not know if that is the right way to look at this.

Senator LINCOLN. That is just the statement from the administration.

Secretary SNOW. But higher-income people are now paying more than they did before, and many people have jobs who did not have jobs, and the jobs that are being created, if you look at the statistics—and I will be glad to share them with you—something like 60 percent, are above the median income.

Senator LINCOLN. Well, how much of that——

The CHAIRMAN. Senator, your time is up.

Senator LINCOLN. All right. Can I just follow up his statement?

The CHAIRMAN. We will do that on the second round.

Senator LINCOLN. All right.

The CHAIRMAN. Mr. Secretary, there have been lots of States that have been hard hit by the disconnect in the tax law that brings into play the Alternative Minimum Tax with the incentive stock options granted to workers.

On the one hand, the law encourages the taxpayer to hold onto these stocks to get preferential tax treatment, but also subjects them to the AMT when the option rights are exercised.

If the stock then declines after the option is exercised, the taxpayer is faced with a problem of a big AMT bill with no income to pay for it. This is another in a long list of reasons why the AMT needs to be repealed.

But getting back to these families across the Nation, they were particularly hit when we saw the dot-com bubble burst in 2001. So, unfortunately, these are old cases and would require retroactive legislation beyond the 3-year rule of limitations.

I believe that the right solution here is something that we did in 1998 for IRS to exercise its expensing authority in that restructuring bill to provide offers and compromise for purposes of effective tax administration.

I think that these cases fit well within the types of people Congress is trying to assist, people who have honestly paid their taxes for years, but because the law is working at cross purposes, they are caught between a rock and a hard place. Unfortunately, the IRS and Treasury have been overly narrow in construing that authority given in 1998.

I have been pushing for quite some time now to get IRS and Treasury to be more open-minded on this matter, and I would like to note that I particularly appreciate the Taxpayer Advocate's assistance in finding a solution to deal with the Iowa families hit by the AMT on stock options.

So, Mr. Secretary, I would ask not so much a question, but would ask that you please make a priority of looking into this to find a workable solution to take advantage of the broad authority of the offer-and-compromise program that can be helpful for honest taxpayers who are caught in that trap.

Secretary SNOW. Senator, I regret the hardship of your constituents, the unforseen hardship that occurs as a result of this unfortunate application of the AMT. It is yet another reason why the AMT needs to be fixed, needs to be repealed. I will certainly follow up on and see what administrative authority we might have.

I am told that some of these cases may go back 4 or 5 years. They are over 3 years old, which would take us beyond the 3-year statute of limitations. I want to look into that and see what we can do, but I will pledge to you, we will try to find the best answer we can.

The CHAIRMAN. Quite frankly, there are probably 10 times the number of people in California that are affected by this as there are in my State, but of course I hear more from the people in my State.

On another point, recent articles in the *Wall Street Journal* and *New York Times* have reported how U.S. multinationals have been able to dramatically reduce their worldwide tax liabilities by transferring intangible assets to subsidiaries in low-tax countries—and Ireland is a good example—and particularly technology companies and drug companies have transferred an increasing amount of their income-generated intangibles offshore to avoid U.S. tax.

For example, the *Wall Street Journal* reported that a 4-year-old Irish subsidiary of Microsoft called Round Island One, Limited, "has a thin roster of employees, but controls more than $16 billion in Microsoft assets. Virtually unknown in Ireland, on paper it has quickly become one of the country's biggest companies, with a gross product of nearly $9 billion in 2004."

According to the article, much of this profit is from licensing software code that originated in the United States. Reporting this profit in Ireland helps Microsoft save half a billion dollars in annual tax revenue.

The press reports indicate that it is through cost-sharing arrangements that companies like Microsoft are able to accomplish such dramatic tax savings.

These companies enter into cost-sharing arrangements with their foreign subsidiaries, giving those subsidiaries the right to a share of whatever income or loss is generated by the intellectual property developed under the arrangements. Instead of receiving royalties from their foreign subsidies, the U.S. parent receives buy-in payments up front.

Our international tax regime has operated, since 1918, under the fundamental principle of deferral, under which active business earnings earned by subsidiaries of U.S. multinationals are not subject to U.S. tax until those earnings are repatriated to the U.S. parent, usually in the form of a dividend, but also in the form of royalties for the use of intangible property developed here at home.

The reason for this rule is to enable U.S. multinationals to remain competitive with companies based in countries that do not tax foreign earnings at all, for example, a territorial system.

Critical to protecting the U.S. tax base, our system of deferral is an appropriate transfer pricing policy and effective enforcement of the policy. The President's Tax Reform Panel has pointed out that transfer pricing is even more critical under a territorial tax system.

Now, the Treasury Department has recently proposed an overhaul of cost-sharing regulations, and, based upon these press reports, Treasury review of this area is very timely.

So, Mr. Secretary, would you please comment on the priority given to finalizing these regulations?

Secretary SNOW. Mr. Chairman, it is a clear priority for us. We share your concern, the concern you have just articulated. There is a clear danger here that there has been migration of intellectual and other intangible property offshore.

This type of migration can be accomplished through the cost-sharing sort of arrangements that you described. We feel that the existing rules have not been effective in getting at this problem.

As a result, Treasury and the IRS undertook to overhaul, as you noted, the regulations, and proposed regulations were issued sometime back in the summer, I think it was in August. They are being commented on now. We would expect to have them made final sometime in 2006. I agree with you, this is a serious issue and we need to deal with it.

The CHAIRMAN. In order to quantify that, are you headed down the road of these regulations, bringing that $500 million that is saved by Microsoft under this back into our treasury?

Secretary SNOW. Well, I think what this will do is reduce the opportunity for abuse here, and certainly remove some of the incentives to engage in the sorts of behaviors that deny revenues to the U.S. Treasury.

The CHAIRMAN. All right.

Senator Baucus?

Senator BAUCUS. Thank you, Mr. Chairman.

On that same discussion, what is Treasury doing to address the tax gap? My understanding is, not very much. That is, it is about $350 billion of income taxes legally owed, not collected by Uncle Sam. That is $350 billion every year.

Just think of what we could do—lowering taxes and getting the budget deficit down, getting a surplus, perhaps—if we could collect that revenue.

My understanding is, the last really comprehensive study on this issue by the IRS was in 2001. Maybe there is a more updated comprehensive study. But why can Treasury not get down to the bottom of this?

I also understand that this budget that you are proposing makes, in real terms, cuts to the IRS budget; there is certainly no increase in the IRS budget. So what are we doing about the tax gap?

Secretary SNOW. Well, Senator, I will start with agreeing with you that it needs to be addressed. There are some proposals in the budget, I think five proposals that we recommend, that would help deal with it. But the tax gap——

Senator BAUCUS. That is, taxes legally owed, not collected.

Secretary SNOW. Legally owed, not collected. It is one of the challenging problems the IRS has. It always has to get the equation right between enforcing the law and treating taxpayers and citizens properly. Most Americans pay their taxes honestly.

Senator BAUCUS. Does it not make sense for the IRS to have some kind of plan here to reduce it? That is, even to quantify, like, say, a certain percent reduction in the gap over, say, the next year, another percent the following year, to really get at it so we do not continue to just talk about this, as has been the case for many years?

Secretary SNOW. Senator, the tax gap goes back many, many years.

Senator BAUCUS. I am saying, many years.

Secretary SNOW. Many, many years. As you know, I think Commissioner Everson testified before you that you would be very unhappy with the sorts of behaviors you would see in the IRS if they were to make——

Senator BAUCUS. We need a plan. We need a solution. We do not need a recitation of difficulties. We just need a solution. We need a plan, here.

Secretary SNOW. The IRS is continuing to work on it. They are aware of this, Senator. They are continuing to work at it. They have these proposals in the budget. We have taken up enforcement. You have seen the enforcement budget strengthened over the last couple of years.

Senator BAUCUS. Here is what we will do. Next time you appear before this committee—I do not know when it is going to be—do you think it makes sense for you to give us an update?

Secretary SNOW. I would be happy to.

Senator BAUCUS. Quantifying it.

Secretary SNOW. I will be happy to.

Senator BAUCUS. On what you are doing in real terms, not smoke and mirrors, to actually reduce it. Can you do that?

Secretary SNOW. I will be happy to do that. I will lay out for you how the IRS enforcement activities have grown as a proportion of their total budget.

Senator BAUCUS. That may be. I am only interested in results here to get that gap down.

Secretary SNOW. We are with you.

Senator BAUCUS. All right.

Second, you mentioned that 50 percent of Americans with incomes, I think, of $50,000, benefit from the current dividends and capital gains reduction. That may be true.

But is it also true that, in terms of dollars, that wealthier Americans get by far the greatest benefit of this? Let me give you some figures and you can tell me if you agree with this or not.

According to Joint Tax, three-quarters of the capital gains and dividend income is held by taxpayers making over $200,000 a year. That is three-quarters of the total gain or reduction in taxes is made by taxpayers making over $200,000 a year, and 84 percent of the capital gains income alone is held by taxpayers making over $200,000 a year. Those are Joint Tax figures for this last year.

Now, the most recent data we have is 2003 from the IRS on the distribution effect. That is, what income taxpayers get what benefits? What I have here, this is 2003, for taxpayers who earned $50,000 a year or less, IRS figures, the average savings for them with the cuts is $24 a year. That is about $2 a month.

Whereas, the average savings for taxpayers at $200,000 or more for any of this, according to IRS figures, is about $7,900, close to $8,000 a year. So, in terms of the distributional effects, by far most of the benefit is for wealthy taxpayers.

Now, if you just contrast AMT, for example, with capital gains and dividends, I think the data will show, Mr. Secretary, that the average taxpayer who gets the bulk of the AMT relief is around $50,000, $75,000, $150,000 taxpayer.

That is 52 percent of all the tax paid under AMT, a little more than half, is by taxpayers in the income brackets of roughly $75,000 up to about $200,000. Contrast that with the taxpayers who get by far most of the gain under the capital gains dividends reduction, who are taxpayers with income over $1 million.

In fact, you cannot see it from where you are, but I have the chart here that shows it. I know you cannot see it, but the red is capital gains dividends for taxpayers earning more than $1 million, and the blue is for people who pay AMT.

So you can see, clearly, taxpayers in the higher-income bracket get by far much greater benefit under capital gains dividends tax laws than they do under AMT, which is another way of saying AMT does not hurt wealthy taxpayers.

Wealthy taxpayers do not care about AMT. They do not care about it because it does not affect them. But, rather, middle-income taxpayers, those whose incomes are roughly $75,000 to $150,000, $200,000, they really get hit. Those are the facts.

Secretary SNOW. Right.

Senator BAUCUS. After that, AMT has to be fixed, otherwise taxpayers this year, 2006, are going to have to pay. Whereas, the dividends/capital gains provisions are in effect this year, 2006, they are in effect next year in 2007, they are in effect next year in 2008. They do not expire until 2009.

So I am wondering why, in terms of priorities, is the administration not addressing the big tax increase that people are going to pay under AMT, middle-income taxpayers, rather than being so worried about helping those whose incomes are above $1 million in a tax provision that does not expire until 2009?

Secretary SNOW. A couple of points, Senator. One, the AMT, as I have said, is being addressed for a permanent fix.

Senator BAUCUS. Where?

Secretary SNOW. In the broad-based reform the President——

Senator BAUCUS. What reform? That thing is dead.

Secretary SNOW. The tax reform that the President is committed to doing.

Senator BAUCUS. Nobody is paying attention to that.

Secretary SNOW. We do not accept that.

Senator BAUCUS. I am telling you, Congress——

Secretary SNOW. We are going to join with Senator Wyden and try to——

Senator BAUCUS. Congress thinks it is dead. Let me tell you, Mr. Secretary, Congress thinks it is dead. That is going nowhere.

Secretary SNOW. Well, Senator Wyden did not think it was dead.

Senator BAUCUS. No. He is not talking about that. He is talking about something else. He is talking about efforts to simplify the tax code.

Secretary SNOW. And so are we.

Senator BAUCUS. And not the Capital Gains Tax Reform Commission.

Secretary SNOW. As part of that, we are going to push for relief from the AMT. It is part of our broad-based tax reform proposal.

Senator BAUCUS. Is it in the President's budget, tax reform?

Secretary SNOW. The President is——

Senator BAUCUS. I do not see it in this budget, so I am just curious.

Secretary SNOW. The President is on record as strongly supporting broad-based tax reform.

Senator BAUCUS. It is not in the budget. It is not in the budget. Anyway, my time has expired.

Secretary SNOW. His position on that is clear.

Senator BAUCUS. My time has expired. Thank you.

The CHAIRMAN. Before I go to Senator Wyden, this is a question to Senator Baucus. You asked, the next time he appeared before the committee. Now, that could be a long time on this tax gap.

We could arrange for you, I, and any members of the committee that wanted to come to, maybe a month from now, maybe a rump session just in case there is not a reason to have him up here for a formal session.

Senator BAUCUS. Nothing that formal.

The CHAIRMAN. You want it to be open?

Senator BAUCUS. Open, definitely.

The CHAIRMAN. Well, yes. But that could be months from now.

Senator BAUCUS. It could be. It could be.

The CHAIRMAN. All right.

Senator BAUCUS. But I want the progress between today and a month from now.

The CHAIRMAN. All right.

Senator BAUCUS. We need to have a plan here on the tax gap.

The CHAIRMAN. Yes. I was just going to offer you something sooner.

Senator BAUCUS. I appreciate that.

The CHAIRMAN. All right.

Are you the next one, Senator Wyden?

Senator WYDEN. Yes.

The CHAIRMAN. Yes. Go ahead, Senator Wyden.

Senator WYDEN. Thank you, Mr. Chairman.

Mr. Secretary, I do appreciate your willingness to work on bipartisan tax reform. My concern is that the sand is going to run out of your hourglass pretty quickly.

Now, the reason there was tax reform in 1986, as you will recall, the Republican President, early on in his second term, joined with bipartisan members of this committee, Bill Bradley, Bob Packwood, and others, and got it done. The reason that bipartisan group did it is they pushed themselves. They set deadlines.

As a result, they were able to up-end the popular wisdom, which is always, you cannot possibly reduce tax reform. Everybody always says it until 10 minutes before legislation actually appears.

My concern is that you all do not have any deadlines that I can actually pin down. So my question to you is, Mr. Secretary, again, in the hopes that we can get a bipartisan effort under way, has the President given to you a deadline when your recommendations for tax reform would be given to him?

Secretary SNOW. No. We do not have any hard and fast time line on this, as I indicated earlier. But we are committed to giving the President our recommendations and working with the White House on it so that we will be able to have a well thought through set of proposals with a sense of where the analysis takes us towards fairness, towards the growth, and the simplification, all those components combined. It is a big undertaking. It is a big undertaking.

We want to get it right, Senator. That is what I was saying. We only get a chance once every 20 years. We want to get it right. We have not put ourselves on an artificial time clock, but we are working on it hard, and we are going to give the President our thinking as soon as we can.

Senator WYDEN. I just would tell you, I think without any deadlines, you cannot make it happen. I spent the whole year, Mr. Secretary—the entire year—scouring the tax system in order to present my proposal.

The Congressional Research Service has given us what essentially is an informal estimate: it will save more than $100 billion over 5 years. It will provide tax relief to millions of middle-class people, people who make $80,000, $90,000.

I am not saying it is the last word, but it would give us a chance to build on this tremendous effort of 1986. I think I am going to move on now. If you do not set any deadlines, it is going to make it very tough for the Chairman, Senator Baucus, all of us who would like to work on this, to make progress.

I will tell you, I share your view. To really do AMT right, it has to be part of a comprehensive effort. But yet, tax reform was not even mentioned at the State of the Union address. So people are waiting for some leadership, and I hope we will get it.

Secretary SNOW. I will look forward to continuing our discussion on this.

Senator WYDEN. I want to do that.

Let me ask you about the question of tax policies that encourage oil addiction. Now, the President, to his credit, has said we are addicted to oil and he wants to break the habit.

To do that, you have to end the "fix," which in my view is reducing the billions of dollars of subsidies to the oil sector that Congress hands out. In fact, they were just increased last year as part of the energy bill.

Would you support a significant reduction in those oil subsidies now that the President wants to make a break with this oil addiction?

Secretary SNOW. Senator, I would have to look in detail at what we have proposed here on energy. I think what we have primarily done is try to create incentives for use of hybrids, new technologies, biomass, windmills for fuel.

Senator WYDEN. But they are billions of dollars, Mr. Secretary, in subsidies that the President says are not needed. Let me read you this. The President said, "With $55 oil, we do not need incentives for oil and gas companies to explore." That is the President's statement, yet those subsidies are in the budget.

What I would like to know is, would you work with us to carry out the President's wishes?

Secretary SNOW. The President feels that the best incentive is the marketplace, but that the marketplace can be assisted here in development of these alternative fuels and new technologies, the hybrid technology, particularly.

Senator WYDEN. That is not what I asked, Mr. Secretary. In the budget are billions of dollars of subsidies for the oil sector. I would like to know if you will support reducing them.

We have gotten to the point, Mr. Secretary, where the oil executives themselves say these subsidies are not needed. That is what they said when they came to the Energy Committee. So the President says they are not needed, the oil companies say they are not needed, but it is not reflected in your budget document.

Secretary SNOW. Senator, let me go through the budget document and come back to you. But I do think it is reflected in some ways. For instance, there is a proposal to repeal the accelerated recovery period for various natural gas distribution activities, other things like that.

Let me go through it and come back to you and give it to you. But my recollection is that it does include some of the features of the sort you are calling for.

Senator WYDEN. I would only say—my time is up—that billions of dollars of subsidies that the companies say they do not need remain in your budget. The President says they do not need it.

We ought to work in a bipartisan way, again, at a minimum, to reduce those subsidies and, for example, say, let us get them to the small companies and the independents, but we can make significant savings. Unfortunately, they are not in the budget.

Thank you, Mr. Chairman.

The CHAIRMAN. Senator Schumer?

Senator SCHUMER. Thank you, Mr. Chairman.

Thank you for your staying here a second round, Mr. Secretary. I would like to go back to what we talked about in the first round. I have looked up the statistics. These are IRS statistics.

For people making under $50,000, they have about 1 percent of their income from dividends and capital gains. They would save $11, on average, from the extension. People making between $50,000 and $100,000, more, $77. Now, people making over $1 million would save $32,000, and 51 percent of the entire cut would go to people making over $1 million, more than half.

Do you have any dispute with those numbers? This is taxes. This is the amount they would save in their taxes.

Secretary SNOW. Senator, I would want to review them. But are you agreeing with me now, with what I said earlier, that in terms of the number of people getting the benefits, that it is disproportionately people making——

Senator SCHUMER. No. I do not have the numbers of people.

Secretary SNOW. If you will check my number, I will check yours.

Senator SCHUMER. Do you think the people under $50,000 are going to be dancing in the streets because of an $11 tax reduction?

Secretary SNOW. I think, Senator, that the tax reductions on capital gains and dividends have been part of a strong recovery in the American economy which has created a lot of jobs.

Senator SCHUMER. But you do not dispute that someone making over $1 million, on average, gets $32,000. That is not a normative argument, that is just a fact. Someone making under $50,000 gets $11. Those are the IRS statistics. Do you dispute them?

Secretary SNOW. No.

Senator SCHUMER. All right. Thanks.

Secretary SNOW. But I hope you will not dispute the IRS findings that the people in the top income levels, even with the benefits that you are talking about, are paying a higher share of the total tax bill today than they ever did before.

Senator SCHUMER. Oh, of course they are. I do not dispute that. Their incomes are going up much more, too. That is how taxes work. But I do not want to get into that. If you want to question me at some point, that is just fine.

So here is my question to you. Faced with a choice of AMT relief or capital and dividend extension, an immutable choice, you can only do one or the other, there was a resolution in the Senate which a majority of the Senate supported, 73 votes—I think our Chairman may have voted for it; yes, you did—including our esteemed bipartisan, knowledgeable and wise Chairman, among the other adjectives, all positive, that I do not want to delay the hearings with, voted for this, which said, "providing relief from the Alternative Minimum Tax in 2006 should be a higher priority for the Congress than providing a tax cut on dividend and capital gains income in 2009."

Do you disagree with that?

Secretary SNOW. Senator, I think we are talking about something that is pending right now in the reconciliation.

Senator SCHUMER. Correct. But it goes to your budget as well.

Secretary SNOW. It goes to the budget. Our view on that is that we want to work with the conferees in the Senate and the House to come out with a good outcome.

Senator SCHUMER. Well, so does everybody. That does not tell me much, in all fairness. Everyone wants a good outcome. Everyone wants an excellent outcome. Would you not agree with that?

Secretary SNOW. Of course.

Senator SCHUMER. But do you support the thrust of this amendment, which passed the Senate overwhelmingly?

The CHAIRMAN. To make it easier, I can also say that I said at the time that I could vote for both, see.

Senator SCHUMER. Who asked you to make it easier, Mr. Chairman? [Laughter.]

The CHAIRMAN. You can answer any way you want. If you think you are in conflict with me, do not worry about it.

Senator SCHUMER. Yes. But would you support that? Seriously, do you support the sentiment of what I read, which passed the Senate with 73 votes?

Secretary SNOW. Do I think there is a good case for the AMT relief? Yes. Do I think there is a good case, a strong case for tax dividends, both.

Senator SCHUMER. I understand. I think it is really important that the administration is not willing to put its name on the line, that they are going to bat, first and foremost, for these middle income and upper middle income people who desperately need relief and are getting not $11 back or $77, but thousands of dollars in increases because of the AMT.

I have to tell you, I think the administration is not making this the priority that they should. They have not in this new budget where capital gains and dividends get extended forever, but AMT is just for 2006. I think many, many Americans, many, many voters, many swing voters, many voters from the other side are going to find that a very disturbing thing.

Again, with this AMT burden which is going to, now, I think, 19 million people, all middle income, upper middle income, who struggle, too—I do not agree with those who say just help the very poor, do not help the middle class—are going to be really upset about this. That is what I would say. You can have the last word.

Secretary SNOW. Two things on that. One, we share fully your desire to see the AMT fixed and that burden relieved from the taxpayers. We are committed to do that as part of the broad-based tax reform I have been talking about.

On the percentages, I think it is something like 2.5 percent of taxpayers below 50 percent will benefit from the 1-year extension of the AMT patch, which is a smaller percentage, as we heard earlier.

Senator SCHUMER. Could I ask one more question, Mr. Chairman, since you were taking a little bit of my time?

Senator LINCOLN. He has to go, and I want to ask my question.

Senator SCHUMER. All right. Sorry.

The CHAIRMAN. I want to be fair to Senator Lincoln.

Senator SCHUMER. Fine.

The CHAIRMAN. I cut her off at 7½ minutes. You have been there 7 minutes this time.

Senator SCHUMER. Well, that is 30 seconds' worth.

The CHAIRMAN. But the main thing is, I would like to leave at 5 minutes to 12 and adjourn the meeting, because I have a speech to Iowa constituents.

Thank you, Senator Schumer. Senator Lincoln?

Senator LINCOLN. Thank you, Mr. Chairman.

Mr. Secretary, as I ended my first round, your comment that you have hung on, both there and with Senator Schumer, is that the higher-income group is paying more.

Really, the reason for that, in most instances, is that they have been the greatest beneficiaries, and their incomes are higher. So, I think it is important to put that in perspective.

I would like to also ask you, the budget offers very few offsets for policies in the budget. However, one of the largest revenue offsets would raise $3.3 billion from low-income working families by simplifying the refundable child credit, basically looking at the number of children and the formula that deals with that.

Can you explain why the President thinks it is all right for these hardworking families with children to have a tax increase, but no one else? You might want to explain the details, exactly how the revenue is being raised or which families will be hurt the most. But from my indication, it looks like the families with children.

Secretary SNOW. Senator, let me just comment on your broad thrust here, because I think it paints a picture that really is not consistent with the facts.

The President's tax cuts, which Congress enacted in 2001 and 2003, have had the effect overall of making the tax code more progressive. It did so in a variety of ways, but basically it reduced tax rates less on higher-income people than it did on lower-income people.

Senator LINCOLN. Well, Mr. Secretary, and I just assume that you and the President are aware that the threshold that earnings must exceed in order for families to receive a refundable Child Tax Credit rises each year with inflation, but the minimum wage has not risen in over a decade.

So I know you understand that that results in a smaller and smaller credit each year for poor working families, because those parents make a minimum wage. So if the threshold in 2005 was $11,000, which it was, a single parent working 40 hours a week, 52 weeks a year only brings home a salary of $10,712.

As we are seeing in many of the proposals, they are requiring more and more work hours, particularly of single women with children, single mothers who are working minimum wage jobs.

Secretary SNOW. Senator, to go through the long answer here, the detailed answer, would take more time than we have. But I will send you a detailed answer here that shows that lower-income families are coming out much better as a result of the President's tax relief package that the Congress adopted in 2001 and 2003.

Senator LINCOLN. I would certainly be happy to look at what you want to send me, Mr. Secretary. But I do not think you can dispute the fact that, without de-indexing the refundability of this Child Tax Credit, you are going to continue to see the limits go up while their wages remain stagnant.

So I guess, in terms of that, you are going to see more and more, particularly single working moms, who are going to have less and less access to a Child Tax Credit, presumably those who need it the most.

Secretary SNOW. I will look into the details of that.

Senator LINCOLN. Well, Senator Snowe and I are working on that. We would certainly love to have the administration support us, and hope that we could count on you on that de-indexing of the credit and the lowering of the income threshold.

As long as the million-dollar folks are going to benefit, it would be great, I think, to see and recognize that there are working families in this country that fall below that threshold, which makes them ineligible.

Secretary SNOW. Senator, I will send you a detailed discussion of how the President's tax reductions have helped lower-income people.

Senator LINCOLN. And I am not disputing that there has been some help. I was one of the ones on the floor fighting for that. But I guess the question I would have is, if you think it is all right to leave out single, low-income workers from the Child Tax Credit, which is going to continue to happen.

Secretary SNOW. Senator, we will look at the issue you raised. I do not have the command of the facts at my fingertips now, but I will look at it and respond to you.

Senator LINCOLN. Well, that would be great. The question would certainly be whether you think it is all right to leave out those single, low-income working families from the Child Tax Credit.

The last thing I just want to touch back on was the last question I had in the first round in terms of the sacrifices. In reviewing the budget in a preliminary way, seeing the kind of cuts, the 63-percent cut in children's hospitals, the lowest funding for education, we have seen our rural health programs cut by 73 percent, in terms of the Child Tax Credit, there is an issue there.

And then certainly the issue we have, a waiting list in Arkansas for children who need after-school programs, but with this budget, we are going to see over 19,000 children in Arkansas who are going to be denied after-school services next year because of this budget.

I just am interested to know what the perspective of the administration is on the investment that needs to be made in our children in terms of education, after-school care, health care, and the needs that exist out there, and why it is not reflected in this budget.

Secretary SNOW. Well, I think you heard the President, in his State of the Union message, make a strong declamation about the importance of education and his commitment to strengthening the educational capacity of our country to turn out numerate and literate children.

Senator LINCOLN. Right.

Secretary SNOW. To take the things that have worked to the secondary schools, as well as the primary schools, to focus on math and science and make that broad-based commitment to have an education system that turns out kids that really can compete.

Senator LINCOLN. Right.

Secretary SNOW. That was a strong message.

Senator LINCOLN. Yes. And I am so grateful for the President for his optimism and his willingness to talk about those very challenging issues we face in this Nation.

I just hope that we can walk our talk on that, that we will not just talk about it, but we will actually make those investments in our children and our future leaders.

Thank you, Mr. Chairman. I appreciate your indulgence.

The CHAIRMAN. Thank you.

Mr. Secretary, we thank you very much. I have no closing comments. We just appreciate your cooperation, your patience, and look forward to continuing to work with you, and ask you to give real serious consideration to that AMT issue that I brought up.

Secretary SNOW. I will. I promise to do that, Mr. Chairman.

The CHAIRMAN. Thank you. Thank you very much.

Secretary SNOW. Thank you.

The CHAIRMAN. The hearing is adjourned.

[Whereupon, at 11:55 a.m., the hearing was concluded.]

APPENDIX

Additional Material Submitted for the Record

Statement of U.S. Senator Max Baucus (D-Mont.)
U.S. Senate Finance Committee Hearing on the President's FY2007 Budget Proposal
(as prepared)

The Proverb says: "A good man leaves an inheritance to his children's children."

Today, we discuss the budget and American competitiveness. And the budget is a statement about what kind of world will we leave to our children and to our children's children.

Will we leave them prosperity? Or will we leave them debt?

Will we leave them better jobs? Or will we leave them third-world wages?

Will we leave them a brighter life? Or will we leave them a standard of living in decline?

That is what the budget is about. And that is why we must focus on America's competitive place in the world.

For the last five years, the Federal budget has left debt to our children. The President's Budget released yesterday continues that legacy in the current year, in the next year and in the years beyond that.

From 1997 to 2001, the Federal debt held by the public declined about $1,600 per person. That lightened by $6,400 the burden hanging over every family of four.

But since 2001, the Government has been adding burdens for our children and our children's children. The budget before us today shows that from the end of fiscal year 2001 through the end of fiscal year 2008, this administration will have added more than $7,700 in publicly held Federal debt for every man, woman, and child in America. That's about $31,000 of new debt for a family of four, thanks to the current budget policies.

That is one way in which this administration's fiscal policies are taking from our children and our children's children.

Moreover, the Government borrows much of this money from central banks in China, in Japan, and in other foreign countries' institutions. America is borrowing 80 percent of the world's annual savings. We are handing our children and our children's children a set of obligations that they will owe to foreign central banks.

The budget affects whether our children will receive the education that they need to compete. The budget affects whether health care costs will hobble American families and businesses. And the budget affects whether American research and development will remain at the cutting edge.

I want to leave to our children and our children's children an economy where health care coverage is our economy's strength, not its greatest burden. I want to leave to our children and our children's children an economy where workers and companies look to foreign shores with hope and ambition, not fear and trepidation. I want to leave to our children and our children's children an economy that set records for investment, not deficits.

Whether we succeed or fail is a matter of choice. Will we choose to invest in education? Will we choose to rethink how we fuel our economy and our cars? Will we choose to guarantee that every American has health care coverage? Will we choose to discipline our budget?

I believe that America is ready for tough choices. So I have spent much of the last year developing an agenda to help us make the right choices to ensure that we have a competitive economy in the future. Over the past seven months, I spoke on the floor of the Senate to identify seven key areas that determine economic competitiveness. These areas are education, energy, health care, research and development, taxes, international trade, and national savings. Two weeks ago, I unveiled a detailed seven-part plan for ensuring our economic competitiveness now and in the future.

I was heartened that the President's State of the Union address and now his budget have included proposals for improving our economic competitiveness. And I look forward to working together with him and Senator Grassley to enact those proposals.

But the President's plan is not bold enough. It needs to be bolder. And in some areas, the President's plan goes in the wrong direction. There, it should not be adopted at all.

Here's how some of those areas shape up:

On education, I'm for improving math and science education, as the President wants. But I don't want to just encourage kids to take math and science classes. I want to let them know that if they take those classes, and choose to major in those subjects, we will make their college tuition free.

The President wants to bring more math and science professionals into the classroom. I want to double their salaries to keep them there.

On energy, I'm for increasing research that can lead to energy independence, as the President wants. But I don't want just to increase funding. I want to create the Advanced Research Projects Agency for Energy — ARPA-E. This independent arm of the Energy Department would follow the lead of DARPA at Defense. It would find the most cutting-edge solutions to our energy problems. It would help to shake our addiction to foreign oil.

On health care, competitiveness demands that we address spiraling health care costs. And compassion demands that we extend the security of meaningful health insurance coverage to millions of uninsured Americans.

I am concerned that the President's budget proposals will do little or nothing to reduce costs or expand coverage. Moreover, his emphasis on Health Savings Accounts and high-deductible policies could make meaningful coverage even less available to those who need it most.

I am also concerned that the President's emphasis on individual health insurance plans could undermine coverage for the more than 60 percent of Americans who get health insurance through their employers.

In Montana, 52 percent of the non-elderly have coverage through their employers. Nine percent of Montanans have individual insurance. We need to treat the nine percent fairly, without undermining the employer-based system that covers 52 percent of our citizens.

And we need to extend health coverage to the 22 percent of Montanans who have none at all.

On research and development, I'm for making the R&D tax credit permanent, as the President wants. But I also want to simplify and streamline the credit to make sure that American innovators can get it and use it to do great things.

On trade, this administration has pursued politically-motivated trade agreements with very small countries of little economic significance. Those agreements create few jobs at home. I have criticized these pursuits.

And in response, Ambassador Portman has stepped up his engagement with commercially significant partners in Asia — Korea and Malaysia, in particular. I encourage the administration to make more of these types of engagements.

Moreover, I will soon introduce a Trade Competitiveness Act that will make the administration more politically accountable to Congress in identifying and pursuing the most egregious foreign market access barriers. This Act will also create a new Senate-confirmed Chief Trade Prosecutor at the office of the United States Trade Representative that will be dedicated to investigating and prosecuting trade enforcement cases.

On savings, I'm for increasing savings, as the President wants. We need to increase savings to spur increased investment. And increased investment spurs greater productivity. And greater productivity makes our products more competitive in a global economy.

But his proposals on personal savings create incentives for those who already save to move their funds around. They will not have the effect of increasing personal savings. Rather, we must provide workers with new opportunities to save, and help those with too little income to benefit from current tax incentives to save for their futures.

And we cannot forget public savings. When governments run surpluses, they contribute to savings. When they run deficits, they detract from savings. This administration has been running massive deficits.

We needed tough pay-go rules to force the President and the Congress to pay for any new entitlement spending or tax cuts. We did not have those rules during the last few years. And this contributed to deficits becoming far too large.

Will we have such rules in the future? Unfortunately, the President opposes them. I think that they are critically necessary.

Let us chose to be good public servants. Let us leave an inheritance of prosperity, and not debt, to our children and our children's children. And let us leave them a brighter life in the competitive world to come.

# # #

STATEMENT FOR SENATOR BUNNING
SENATE COMMITTEE ON FINANCE
REVENUE PROPOSALS IN THE PRESIDENT'S FY 2007 BUDGET
8 February 2006

Thank you, Mr. Chairman.

Welcome to the Committee today Secretary Snow. I look forward to a meaningful discussion of the tax provisions contained in the president's budget proposal.

As I have reviewed the many revenue proposals released yesterday, I have been pleased to see the attention paid by the Administration to so many important areas – changes to Medical Savings Accounts, simplifying the tax laws, encouraging savings, as well as extending many expiring provisions.

There are a number of proposals that I am interested in hearing more about including changes aimed at making health insurance more affordable.

Obviously, this committee and Congress as a whole gave a lot of attention to pension plan funding last year. I was pleased to see that the Administration is also continuing to take a serious look at private savings. I suspect that a popular topic today will be the savings plans that this Administration has included in yesterday's budget proposal and that we have seen in prior years. The concept of simplification of retirement savings plans is intriguing and I look forward to learning more about those proposals and the benefits that the Administration feels they will bring to the savings of Americans.

Thank you.

Statement of Senator Chuck Grassley
Chairman, Committee on Finance
Finance Committee Hearing on Administration's Budget: Revenue Proposals
Tuesday, February 7, 2006

This is the first in a series of hearings the Finance Committee will hold on the Administration's budget. Today, we focus on the revenue side of the budget. It is almost entirely in this committee's jurisdiction. Secretary John Snow is our sole witness. Mr. Secretary, President Bush, in his State of the Union address, rightly noted that all of us need to change the tone in Washington, D.C. This committee has a long history of bipartisanship, civility, and problem-solving. And, though, this is an election year, I commit myself to continuing that course. I hope that everyone here, Republicans and Democrats, can agree with me on that point. In that spirit, I'd like to start out with some positive news that every member, conservative, moderate, and liberal, Republican, Independent, and Democrat, should find satisfying. Federal revenue is up. Isn't it, Mr. Secretary? The good news is that we are way ahead of where we thought we'd be at this point last year. Revenue was up by $274 billion for 2005 over 2004. That is a record. Back in 1993, taxes were raised and the then-Chairman, Senator Daniel Patrick Moynihan, termed it a "world-record tax increase." In fact, the revenue raised here, in terms of the year-to-year change, is much higher. The good news is the additional revenue came in without raising taxes on the American taxpayer.

A lot of times around here, folks get it backward. You've heard about the old country saying. It goes, "The tail doesn't wag the dog. The dog wags the tail." Some people think the only way to fix the budget is to raise taxes. A tax increase, they believe, will make the economy better. It's kind of like the Federal tax tail wagging the American economic dog. I've got a chart that proves the point.

If you take a look at this chart, Mr. Secretary, you'll see that Federal revenues respond fairly dramatically to the economic growth. In times of good economic growth, Federal revenues rise. In times of economic recession, Federal revenues decline.

So, in this case, when we put in place the tax relief program in 2003, economic growth started back up. Now, some protest that this was a bad move. They claim that this tax relief, especially with respect to investment income, made the budget and the economy worse. In fact, this chart shows the opposite. Growth has spiked up and so have Federal revenues

The bottom line is that everyone should be happy that the economic dog, a growing national economy, is wagging the Federal revenue tail. It means more Americans are working, investments are performing better, and more money is coming into the Federal Treasury. Everybody wins under that kind of scenario.

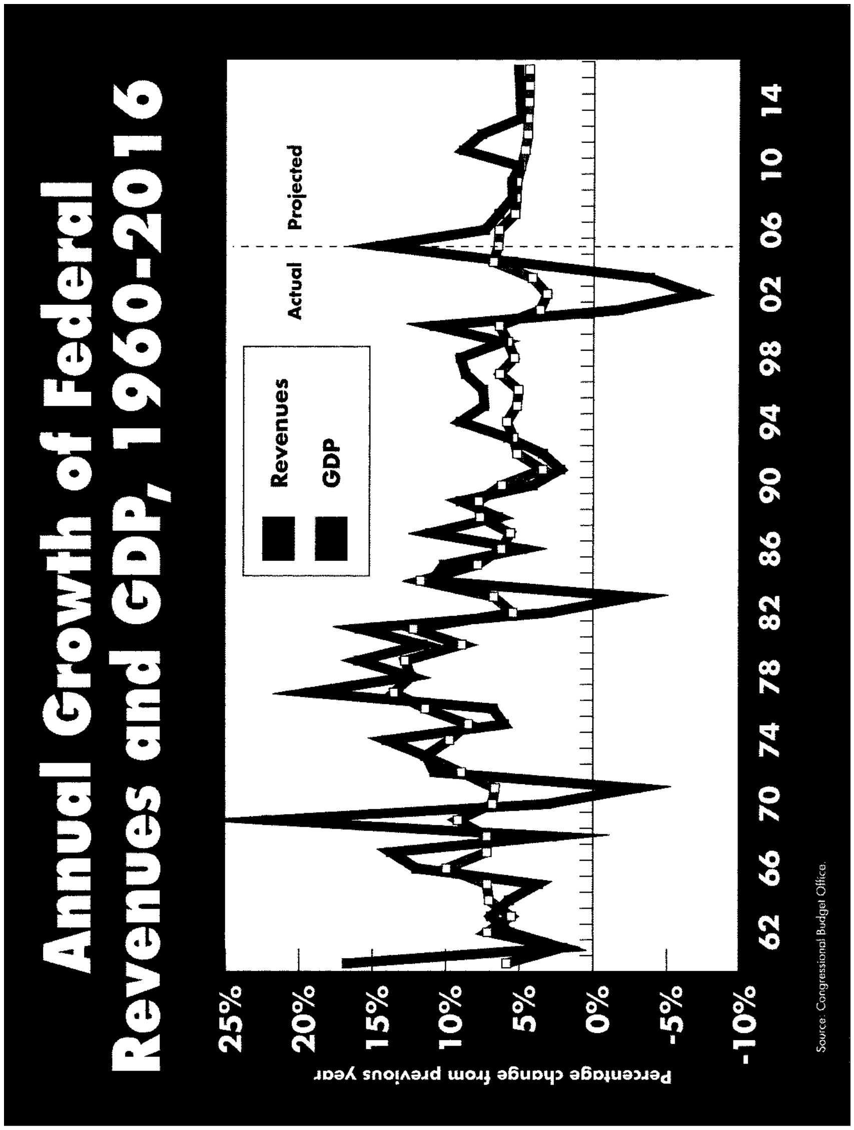
I'd like to bring out one other chart that I think puts the revenue side of the Federal budget into perspective. This chart shows that over the post World War II period, Federal taxes have taken around 18 percent of our economy. It shows that we had a sharp drop in wake of the stock market bubble, 9-11, and other factors in the early part of this decade. Now, with all of the bipartisan tax relief in place, we are on a path that gets us pretty close to the historical average. If you look closely, you'll see at once the effect of the tax relief sunset, out in 2010. Not surprisingly, as a percentage of GDP, taxes will be far above the historical average. Some would like to go that way now. My concern is that the effect is that the revenue tail would be the focus. We would be taking our eye off the dog, a growing national economy.

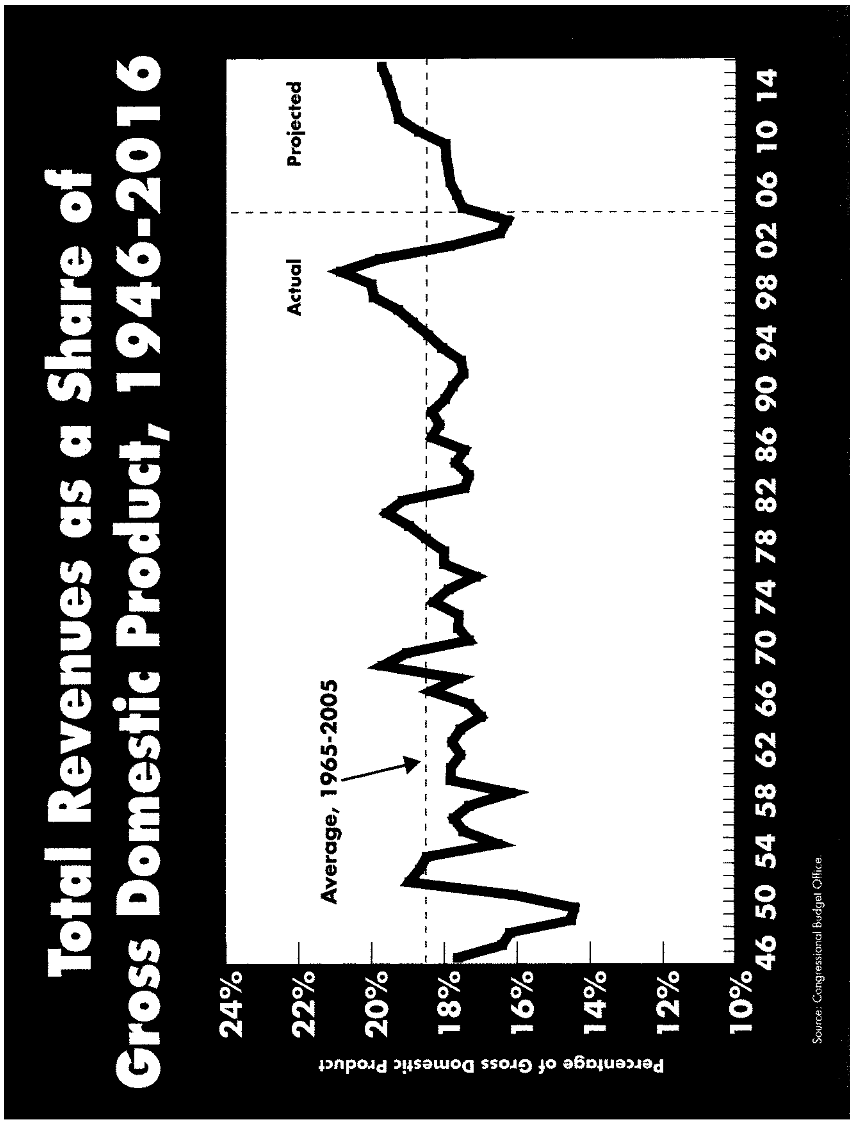
Now, Mr. Secretary, I'm not saying there aren't problems with the budget in the mid- and long-term. Certainly, these projected deficits must be dealt with. The deficits, however, are driven by Federal spending. Federal spending is off track. It is high, as a percentage of our economy. It is trending between 1 to 2 points higher than that historical average of Federal revenues to GDP. The problem is clear. It is on the spending side. It is not on the revenue side.

The critics of the bipartisan tax relief plan come to the table with one agenda only. It is to raise taxes. The harshest critics are those who are least willing to look at the spending side of the ledger. That's where the problem is. Just look at how hard it was to get a bipartisan deficit reduction bill through the Senate.

Since today's hearing is about revenues, I wanted to put this part of the budget into context. I want us to reflect on the good news of a growing economy, a program of bipartisan tax relief, and the growing amount of Federal revenue. There is good news here. But we have tough news in that we have to get the spending side of the budget under control.

Mr. Secretary, today we will examine the Administration's budget's revenue proposals. We look forward to a constructive discussion on those proposals.


Annual Growth of Federal Revenues and GDP, 1960-2016
Revenues
GDP
Actual
Projected
Percentage change from previous year
25%
20%
15%
10%
5%
0%
-5%
-10%
62 66 70 74 78 82 86 90 94 98 02 06 10 14
Source: Congressional Budget Office.


Total Revenues as a Share of
Gross Domestic Product, 1946-2016
Percentage of Gross Domestic Product
24%
22%
20%
18%
16%
14%
12%
10%
46 50 54 58 62 66 70 74 78 82 86 90 94 98 02 06 10 14
Average, 1965-2005
Actual
Projected
Source: Congressional Budget Office.

SUBMITTED BY SENATOR LINCOLN

109TH CONGRESS
1ST SESSION

S. ______

To amend the Internal Revenue Code of 1986 to modify the income threshold used to calculate the refundable portion of the child tax credit.

IN THE SENATE OF THE UNITED STATES

Ms. SNOWE (for herself, Mrs. LINCOLN, Mr. CHAFEE, Mr. OBAMA, and Mr. ROCKEFELLER) introduced the following bill; which was read twice and referred to the Committee on

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A BILL

To amend the Internal Revenue Code of 1986 to modify the income threshold used to calculate the refundable portion of the child tax credit.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Working Family Child Assistance Act".

SEC. 2. $10,000 INCOME THRESHOLD USED TO CALCULATE REFUNDABLE PORTION OF CHILD TAX CREDIT.

(a) IN GENERAL.—Section 24(d) of the Internal Revenue Code of 1986 (relating to portion of credit refundable) is amended—

(1) by striking "as exceeds" and all that follows through ", or" in paragraph (1)(B)(i) and inserting "as exceeds $10,000, or", and

(2) by striking paragraph (3).

(b) EFFECTIVE DATE.—The amendments made by this section shall apply to taxable years beginning after December 31, 2004.

(c) APPLICATION OF SUNSET TO THIS SECTION.—Each amendment made by this section shall be subject to title IX of the Economic Growth and Tax Relief Reconciliation Act of 2001 to the same extent and in the same manner as the provision of such Act to which such amendment relates.

STATEMENT OF SENATOR ROCKEFELLER

SENATE FINANCE COMMITTEE

FEBRUARY 7, 2006

Mr. Secretary, I am very disappointed with the President's budget proposal. Rather than offering responsible solutions to our nation's fiscal troubles, this budget offers only more of the same policies that have put us in so much trouble in the first place. And instead of delivering much promised tax reform and simplification, the budget focuses on continuing failed tax cuts that benefit primarily the wealthiest Americans.

I detect three recurring themes in the tax policies proposed in the fiscal year 2007 budget. First, the president insists on continuing along the fiscally irresponsible path of more tax cuts for the wealthy. He calls for making all of his tax cuts permanent. I share his desire to continue tax relief for working families, with such policies as the 10% tax bracket, the child tax credit, and relief from the marriage penalty. However, the president also advocates hundreds of billions of dollars of tax relief for millionaires. Indeed, this budget puts a higher priority on extending investor tax cuts for 2009 – tax cuts for which more than half the benefit goes to millionaires – than it puts on relief for middle income families facing the Alternative Minimum Tax next year. These are misguided priorities.

The second theme obvious again in the president's budget is the shifting of risk onto individuals. At a time when many people are already losing pension benefits and health care coverage, the president's solution is that individuals should fend for themselves more. For example, he proposes tax free savings accounts that will essentially help people who can already afford to save to save more. But such savings accounts are likely to decrease access to employer provided retirement accounts, and will do nothing to help workers who cannot afford to save in existing tax-preferred retirement accounts.

In addition, the president proposes to use the tax code to address our nation's health care crisis. The reality is that tax credits and health savings accounts do not guarantee a single uninsured person access to affordable health insurance. We need look no further than the Trade Adjustment Assistance (TAA) Health Coverage Tax Credit (HCTC) to see the significant limitation of using the tax code to incentivize the purchase of health insurance.

Although 30 months have passed since advance payment of the HCTC began in August 2003, the program still serves less than 10 percent of displaced workers and early retirees who receive notices of potential eligibility. According to a report by the Labor Department's Inspector General, 71 percent of eligible individuals state that the main reason for their nonparticipation is the high premium cost they face, despite the HCTC. Indeed, the president's proposals to use the tax code for individual access to health care undermine the employer-provided health care system.

The final theme which disturbs me about President Bush's budget is his failure to address many of the tough issues that this country faces. This budget does not address fundamental tax reform, and does not even deal with the urgent need to reform the Alternative Minimum Tax (AMT). The AMT is increasingly snaring middle income families for which it was never intended. Last year, the administration promised to present a comprehensive solution, but instead this year it has proposed just another one year patch over the problem. This ignores the enormous long terms costs associated with reforming the AMT.

The president's budget also fails to address the fundamental imbalance between government receipts and government expenses. The budget projects a $373 billion deficit for fiscal year 2007. However, when Social Security surpluses are subtracted from the budget, the deficit – and of course, the national debt – balloon by another $700 billion next year.

As interest rates are increasing, the cost of the enormous government debt is also going up. Interest expense for fiscal year 2007 is projected to reach $247 billion, making interest the largest government expense after Social Security, Medicare, and defense spending. In response, the president has proposed again that 150 programs be either eliminated or reduced, for a total savings of around $15 billion. But $15 billion worth of savings is not a serious solution to a $700 billion deficit.

Mr. Secretary, I hope that my colleagues will join me in rejecting the fiscal plan proposed by President Bush. I hope that we will focus on reasonable tax relief for working families and sound fiscal policies that will not mortgage our children's futures.

UNITED STATES SENATE

New York's Senator

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FOR IMMEDIATE RELEASE
February 7, 2006

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SCHUMER STATEMENT AT SENATE FINANCE COMMITTEE HEARING ON BUDGET

This Budget Shows That You Can't Be an Ideological Conservative and Compassionate at the Same Time

Today, U.S. Senator Chuck Schumer delivered the following statement at the Senate Finance Committee Hearing on the FY 2007 Budget put forward by the Administration yesterday:

I have reviewed the President's budget proposal, and one thing that stands out to me is this: The President's ideology puts him in a straitjacket. The budget makes one thing clear: You can't be an ideological conservative AND be compassionate at the same time.

Look at what this budget contains:

1. Nearly two trillion dollars in additional tax cuts, most of it geared towards the well-to-do, rather than the middle class that's finding it harder and harder to make ends meet with rising health care, tuition, and energy costs.

2. Program cuts that decimate the needy and the middle class in the guise of making courageous choices, when in truth a courageous budget would have cut programs for corporate America, Big Oil, and other special interests.

3. There is a lot of fanfare for new programs such as energy independence and more money for math and science teachers, but so few dollars dedicated to them that these necessary new initiatives amount to all hat, and no cattle.

4. And last but not least, more and more debt. By the end of his second term, President Bush will have presided over a near-doubling of the "birth tax," or the amount of the publicly-held debt owed by every man, woman, and child in America. Even if we were to completely eliminate all non-defense discretionary spending – nothing for education, veterans, and transportation – there would still be a significant deficit.

# # #

DEPARTMENT OF THE TREASURY
OFFICE OF PUBLIC AFFAIRS

SECRETARY JOHN W. SNOW
OPENING STATEMENT
THE PRESIDENT'S FY 2007 BUDGET
SENATE FINANCE COMMITTEE
FEBRUARY 7, 2006

Good morning. Thank you Chairman Grassley, Ranking Member Baucus, for having me here this morning.

I'm pleased to be here today to talk with you about the President's Fiscal Year 2007 budget. This budget represents the President's dedication to fiscal discipline, an efficient federal government and the continuation of a thriving U.S. economy.

Across the board, agencies were asked by the President to look closely at their budgets and make tough decisions, because fiscal restraint is not only necessary for deficit reduction, it is a necessary component of government that is responsible to the people who employ it.

Those tough decisions were made at all levels of government management, and as a result the President's budget holds the growth of discretionary spending below the rate of inflation and cuts spending in non-security discretionary programs below 2006 levels.

The Administration has identified 141 programs that should be terminated or significantly reduced in size because they aren't performing or could perform better with consolidation; they aren't giving taxpayers their money's worth. The savings for the American taxpayer would be 14 billion dollars.

Cutting the programs that aren't working and improving the efficiency of the ones that are is all part of accountability to the taxpayer. To assist lawmakers in this shared effort, the Administration launched ExpectMore.gov, a website that provides candid information about programs that are successful and programs that fall short, and in both situations, what they are doing to improve their performance next year. I encourage the members of this Committee and those interested in our programs to visit ExpectMore.gov, see how we are doing, and hold us accountable for improving.

This budget, with its policies of economic growth and spending restraint, keeps us on track to meet the President's steadfast goal of cutting the deficit in half by 2009.

It also seeks to avoid a tax increase by making the President's tax cuts permanent; I want to take a moment to explain why that is entirely consistent with our deficit-cutting goals.

In short, lower tax rates are good for the economy and a growing economy is good for Treasury receipts. Indeed, our rate of economic growth led to record levels of Treasury receipts in 2005. And, going forward, we project that receipts will rise every year. In 2011 we will again reach, as a percentage of GDP, the levels we've seen over the average of the last 40 years.

And there can be no question today that well-timed tax relief, combined with responsible leadership from the Federal Reserve Board, created an environment in which small businesses, entrepreneurs and workers could bring our economy back from its weakened state of just a few years ago. The American economy is now unmistakably in a trend of expansion, and those trend lines can clearly be traced to the enactment of the tax relief.

Since May of 2003, the economy has created 4.7 million jobs, two million of them in the last year alone. We found out on Friday that unemployment has fallen from 4.9 percent to 4.7 percent, running lower than the average for the 1970s, 1980s and 1990s. GDP growth was three and a half percent last year. U.S. equity markets have risen, and household wealth is at an all-time high.

The U.S. is, as the President often notes, the economic envy of the world. When we look at the underlying fundamentals of the economy, its strength proves deep and solid, and we can see that businesses and workers have every reason to be optimistic about the future.

For example, we see that productivity growth remains strong. Output per hour in the non-farm business sector has risen at an average annual rate of 3.2 percent since the end of 2000, faster than any five-year period in the 1970s, 1980s or 1990s.

Household net worth – that's assets minus debts – is a record high, and not just because of housing. Deposits – the money in checking accounts, savings accounts, and money market funds – are at a record high and are larger as a share of disposable income than at any time since 1993. Defaults on residential mortgage loans at commercial banks are at historic lows.

In the past two years, the economy has generated about 170,000 jobs per month, and that includes the two-month slowdown in job growth in the aftermath of Hurricanes Katrina and Rita. In the past 32 years, new claims for unemployment insurance have almost never been as low as they have been recently, the *only* exception being the peak of the high-tech bubble from November 1999 to June 2000.

Core inflation remains low, and that's good news for everyone.

Independent private-sector forecasts point to continuing good news, and inflation-adjusted hourly wages grew 1.6 percent between September and December and this trend should continue.

We are, it appears, witnessing the tipping point on wages – when incomes rise for workers and business combined, but workers once again increase their incomes faster than businesses. Once businesses have been doing well for a while, they ultimately compete those increases in income away by competing harder for labor. The result is higher wages and higher standards of living for workers.

Both on leading indicators and a deeper background analysis, the American economy proves to be on solid footing. The question that those of us in government must look at now is this: *why* is our economy performing so well and what can we do to continue these positive trends?

It is a sweeping and important question, so today we'll ask a more focused question: what can our *budget* do, or not do, to keep the economy on track?

The answer to that is twofold: first, control spending. Second, don't increase taxes – let taxpayers keep as much of their money as possible to invest and spend.

And of course I use the term "taxpayer" quite broadly. I ask you to think of the individual and family budgets that benefit from lower taxes, but also of the small-business budgets. Lower marginal rates, for example, help small firms because they tend to file their taxes as individuals, not as corporations. We are proposing to allow small businesses to be able to deduct up to $200,000 of business-expanding investment as a permanent feature of the tax code, for example. This tax benefit encourages expansion and job creation in the sector that produces three-quarters of the nation's net new jobs.

Lower rates and a degree of certainty in the system are absolutely critical to keeping our economy, and our excellent rate of job creation, on track. And I cannot say this strongly enough: we can't beat the budget deficit without a strong economy. Tax increases carry an enormous risk of economic damage and I can tell you today that the President will not accept that risk. He will not accept a tax increase on the American people.

Fiscal discipline, combined with economic growth, is the correct path to deficit reduction, period, and we cannot let difficult decisions run us off of that path that we know is right.

Our government does, of course, face economic demands that are exceptional, from fighting the war on terror to helping the victims of devastating hurricanes put their lives back together. These are costly events that lead to unwelcome, brief deficits. They should be regarded as temporary as they are entirely surmountable with continued economic strength and spending restraint in the areas where it is possible and appropriate.

The second way for the budget to help keep the economy on track is to focus the taxpayers' precious resources on things that we know will make a difference.

In order for America to continue to be a dynamic engine of growth, President Bush is outlining action in three key areas: healthcare, energy, and America's competitiveness.

Affordable and Accessible Health Care. The President's reform agenda will help to make health care more affordable and accessible. Health Savings Accounts – putting patients in charge of their health care – will contribute to this goal. We need to make health insurance portable, make the system more efficient, and lower costs. We also need to level the playing field for individuals and the employees of small business by allowing small businesses to form Association Health Plans.

The expansion of high deductible health plans and HSAs is something I'd particularly like to emphasize. Combined with a high deductible health plan, HSAs allow people to save for future health care expenses while providing immediate protection against catastrophic health expenses. Furthermore, by giving people more control over their health care spending, they offer a more affordable alternative to traditional health insurance.

Today, millions of Americans – many of whom were previously uninsured –are enjoying access to more affordable health insurance because of the increased availability of HSA-qualified HD health plans. These plans are more available and becoming more popular, because saving for health care needs in an HSA now has the same tax advantages as a traditional health insurance plan.

It only makes sense to expand the scope of HSA qualified health insurance by making their premiums deductible from income taxes and payroll taxes when purchased by individuals. This is an important innovation that will significantly reduce the cost of health insurance purchased by individuals, particularly important for working people who don't have a federal income tax liability. As many of my friends on the Democratic side of the aisle have pointed out to me - payroll taxes are one of the most significant tax burdens for the poor. This innovation will enable more individuals to purchase affordable health insurance. Expanding HSAs so that policy holders and their employers can make annual contributions to cover all out-of-pocket costs under their HSA policy will further encourage adoption of qualified HDHP plans.

All told, the President's HSA proposals are projected to increase the number of HSAs from the current projected for 14 million to 21 million.

Advanced Energy Initiative. The President has said that the best way to break America's dependence on foreign sources of energy is through new technology. So the President announced the Advanced Energy Initiative, which provides for a 22 percent increase in clean-energy research at the Department of Energy. This initiative also builds on the energy legislation finally passed by the Congress last year that encourages and rewards energy conservation activity.

American Competitiveness Initiative. This ambitious strategy by the President will significantly increase federal investment in critical research, ensure that the U.S. continues to lead the world in opportunity and innovation, and provide American children with a strong foundation in math and science.

This budget also gives us an opportunity to look at the other ways – in addition to keeping tax rates low – that the federal government can make adjustments that add to a growth-friendly environment for the businesses, entrepreneurs and workers that produce that economic growth. Tax code reform remains a priority for this President and the President's Advisory Panel on Federal Tax Reform provided us this year with a strong foundation for a national discussion on ways to ensure that our tax system better meets the needs of our dynamic, 21st century economy. I appreciate the fine work of Senators Mack and Breaux, for their outstanding leadership of the Panel. This issue is also reflected in the budget through the proposed creation of a new Dynamic Analysis Division within Treasury's Office of Tax Policy. Understanding the full range of behavioral responses to tax changes, including how tax changes affect the size of the economy and, subsequently, tax revenues, is critical to designing meaningful, effective tax reform, and we believe this small expenditure will have an enormous pay-off for the American taxpayer.

With a focus on these and other good policies, we'll keep America competitive in the world and keep our economy strong as it has been for some time now.

In closing, I want to point out that a lot of good can come from a smart federal budget, and a considerable amount of harm can come from a bad one. Let's use the FY 2007 budget to make good policy – restrained as the circumstances dictate on spending but aggressive on the expansion of opportunity.

I look forward to working with all of you on enacting this budget. Thank you for having me here today; I'm pleased to take your questions now.

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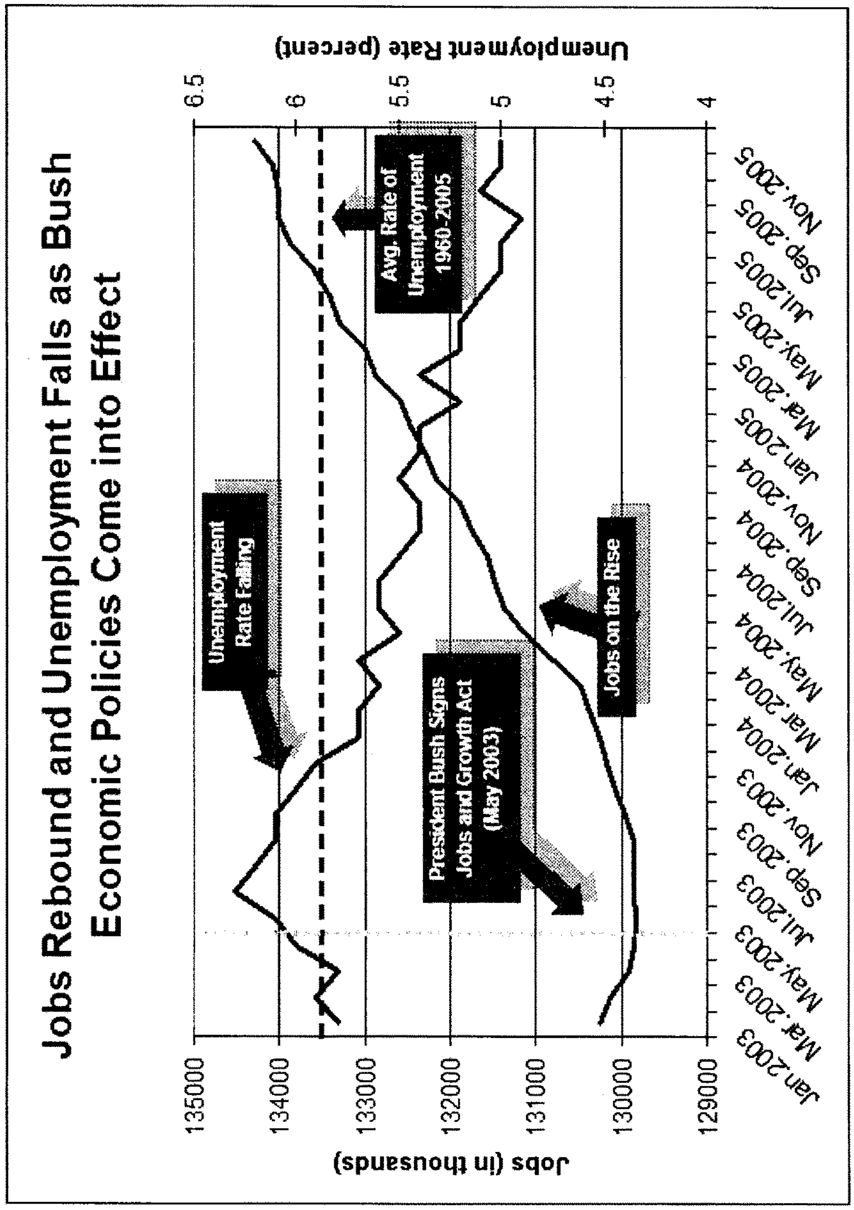
Jobs Rebound and Unemployment Falls as Bush Economic Policies Come into Effect
Unemployment Rate (percent)
Jobs (in thousands)
Unemployment Rate Falling
President Bush Signs Jobs and Growth Act (May 2003)
Jobs on the Rise
Avg. Rate of Unemployment 1960-2005
135000
134000
133000
132000
131000
130000
129000
6.5
6
5.5
5
4.5
4
Jan.2003
Mar.2003
May.2003
Jul.2003
Sep.2003
Nov.2003
Jan.2004
Mar.2004
May.2004
Jul.2004
Sep.2004
Nov.2004
Jan.2005
Mar.2005
May.2005
Jul.2005
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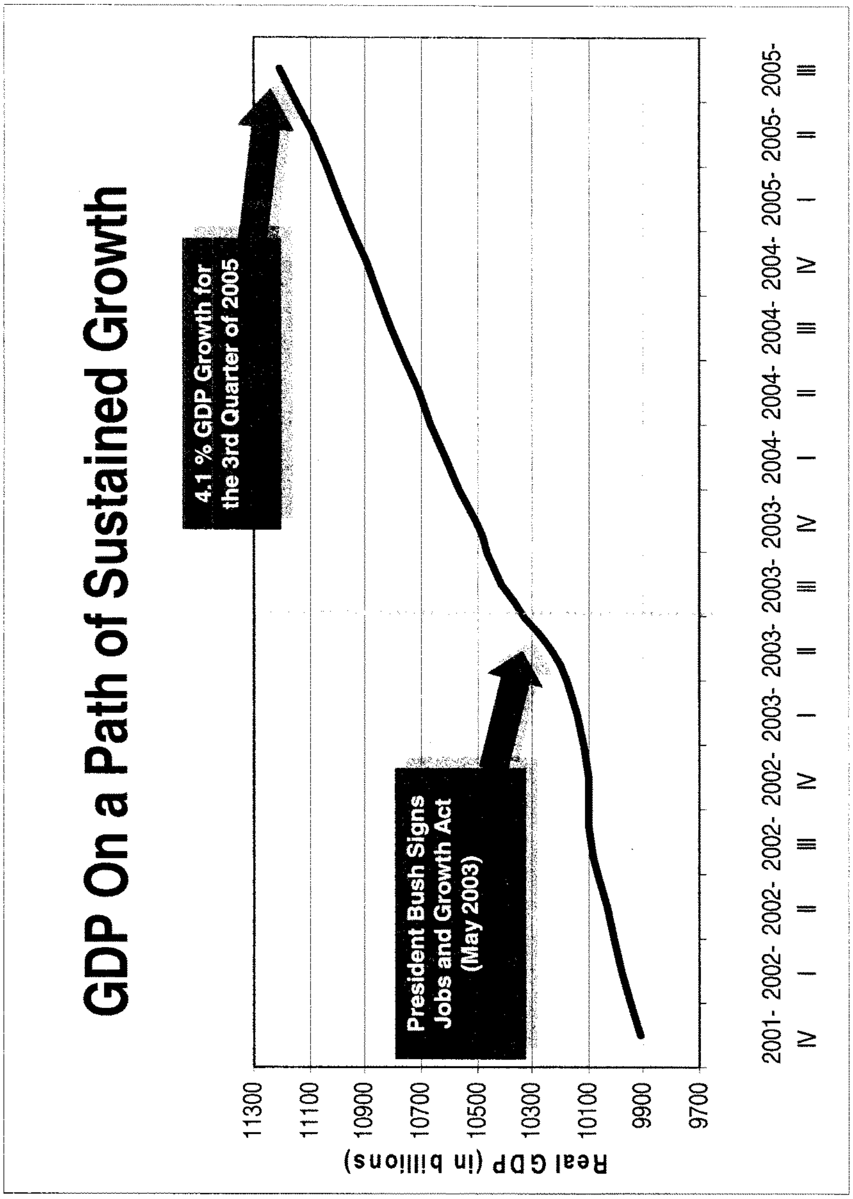
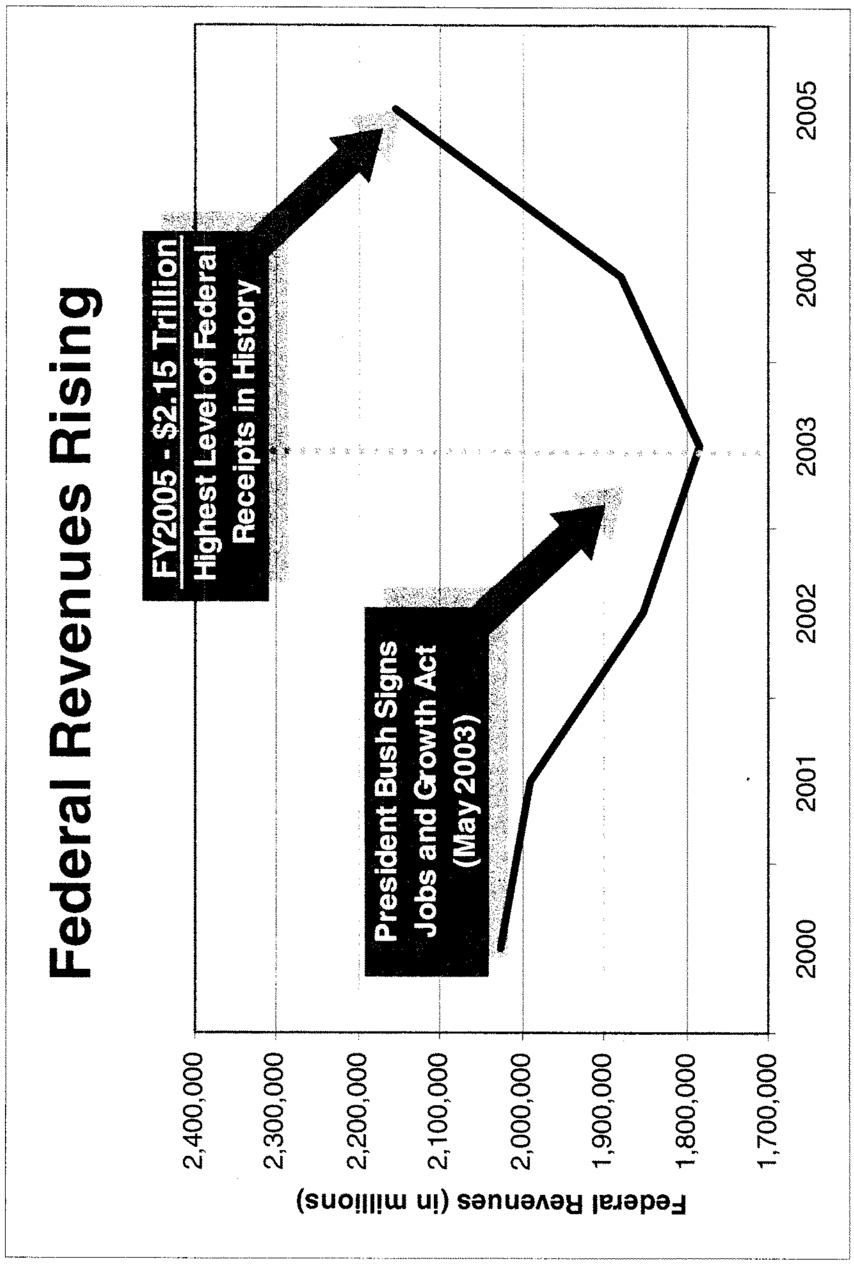
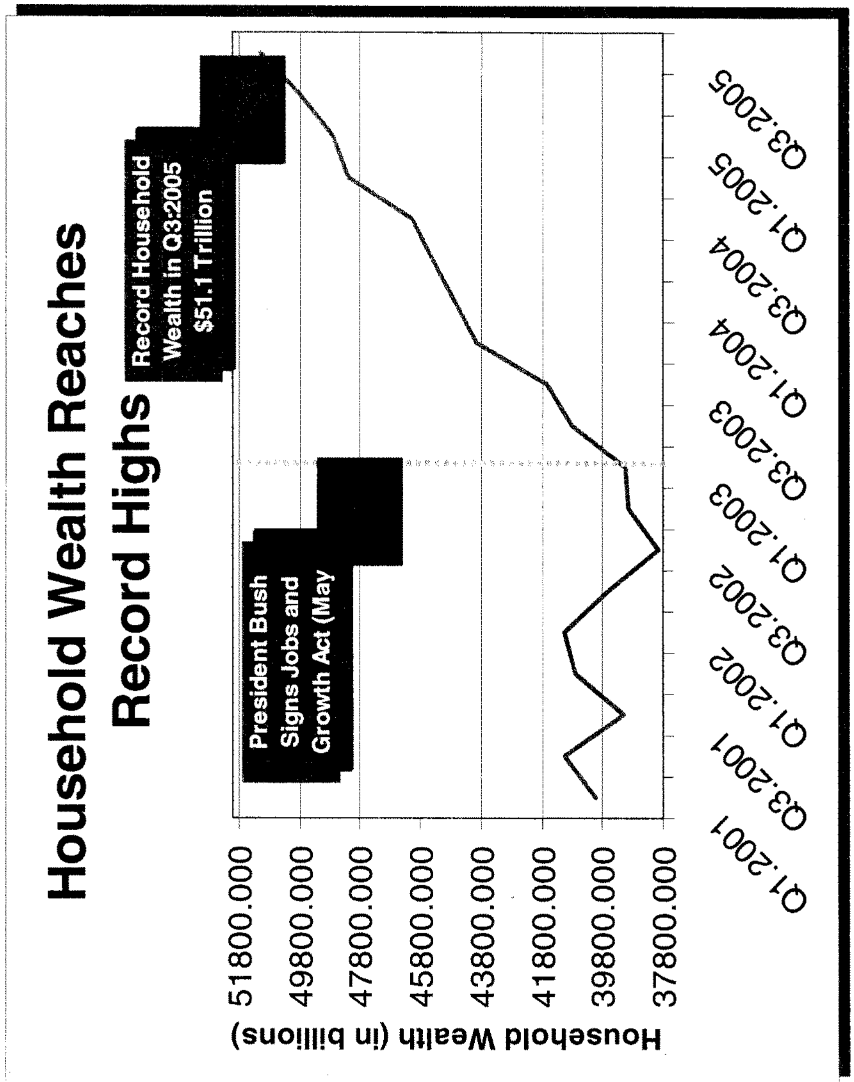
Nov.2005


GDP On a Path of Sustained Growth
4.1 % GDP Growth for the 3rd Quarter of 2005
President Bush Signs Jobs and Growth Act (May 2003)
Real GDP (in billions)
11300
11100
10900
10700
10500
10300
10100
9900
9700
2001- IV
2002- I
2002- II
2002- III
2002- IV
2003- I
2003- II
2003- III
2003- IV
2004- I
2004- II
2004- III
2004- IV
2005- I
2005- II
2005- III



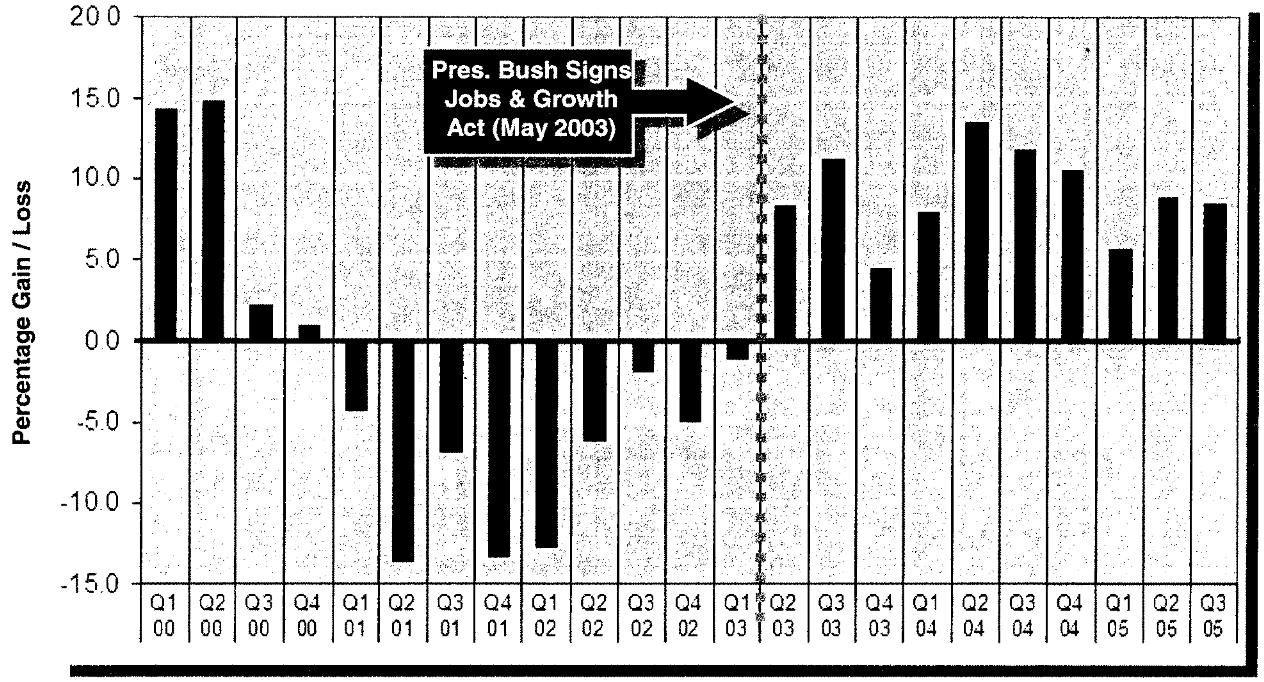
Federal Revenues Rising
FY2005 - $2.15 Trillion
Highest Level of Federal Receipts in History
President Bush Signs Jobs and Growth Act (May 2003)
Federal Revenues (in millions)
2,400,000
2,300,000
2,200,000
2,100,000
2,000,000
1,900,000
1,800,000
1,700,000
2000
2001
2002
2003
2004
2005



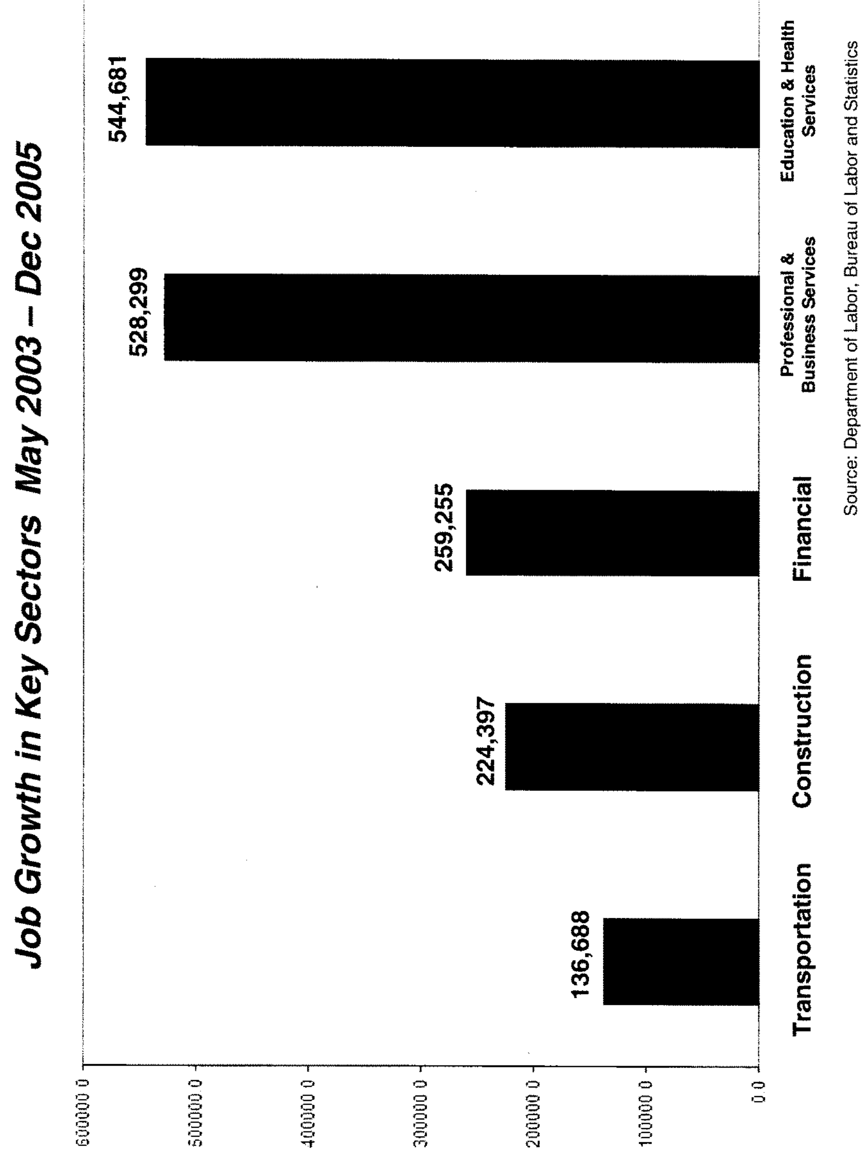
Household Wealth Reaches Record Highs
Record Household Wealth in Q3:2005 $51.1 Trillion
President Bush Signs Jobs and Growth Act (May
Household Wealth (in billions)
51800.000
49800.000
47800.000
45800.000
43800.000
41800.000
39800.000
37800.000
Q1.2001
Q3.2001
Q1.2002
Q3.2002
Q1.2003
Q3.2003
Q1.2004
Q3.2004
Q1.2005
Q3.2005

Tax Relief Spurring Business Investment

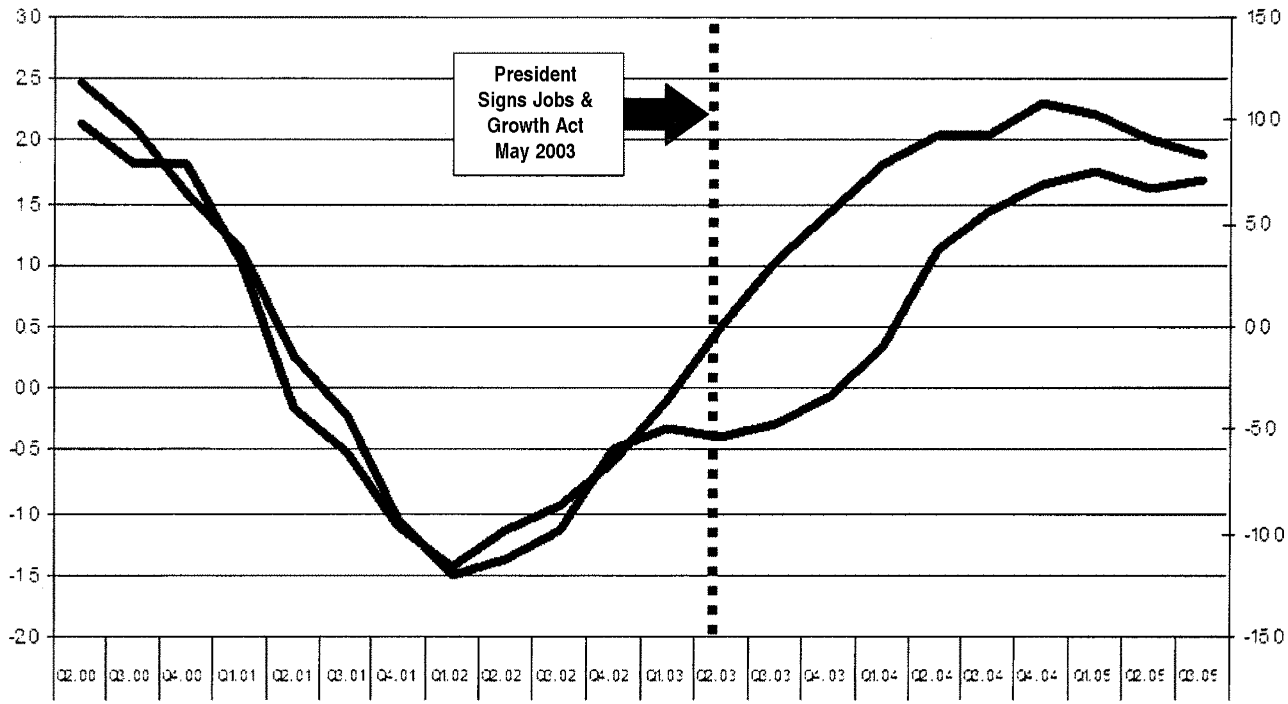
Real Private Nonresidential Fixed Investment



Source: U.S. Bureau of Economic Analysis


Job Growth in Key Sectors May 2003 – Dec 2005
600000.0
500000.0
400000.0
300000.0
200000.0
100000.0
0.0
136,688
224,397
259,255
528,299
544,681
Transportation
Construction
Financial
Professional & Business Services
Education & Health Services
Source: Department of Labor, Bureau of Labor and Statistics

Business Investment & Job Growth – Mirroring Trends



■ **JOB GROWTH** -- All Employees: Total Nonfarm – Source: Bureau of Labor Statistics

■ **BUSINESS INVESTMENT** -- Real Private Nonresidential Fixed Investment – Source: Bureau of Economic Analysis

QFRs – Finance Hearing on FY2007 Budget

From Chairman Grassley:

Grassley Question 1:

Mr. Secretary, please complete the attached table in order to provide me with an update of implementation of listed Energy Efficiency Tax Incentives.

Status of Implementation of Energy Efficiency Tax Incentives

Item	Required rules and guidance	Status	Status as of June 2006
Commercial buildings	Secretary after consultation with DOE shall promulgate regulations that set methods for calculating and verifying energy and power consumption and cost. Secretary after consultation with DOE establish energy-savings targets for the three systems. Secretary to prescribe certification. Secretary to certify organizations that will recognize certifiers. Secretary to determine how to account for new efficiency and renewable technologies. Secretary to provide for recapture if plan not met. Secretary to promulgate a regulation to allow deduction for government property to be taken by property designer	As of late January, Treasury hoped to issue guidance in early February. DOE sent their recommendations last fall, we believe in November (with input from the Tax Incentives Assistance Project and others).	Guidance issued June 2, 2006
New homes	Secretary after consultation with DOE to prescribe guidance on certification (including procedures and methods for calculating energy and cost savings).	As of late January, Treasury hoped to issue guidance in early February. DOE sent their recommendations last fall, we believe in November (with input from the Tax Incentives Assistance Project and others).	Guidance issued February 21, 2006.

QFRs – Finance Hearing on FY2007 Budget

Item	Required rules and guidance	Status	Status as of June 2006
Home improvements	On building envelope, none specified in the law, but guidance needed to clarify what improvements qualify (i.e. the code reference) and what documentation is required. Secretary, after consultation with DOE or EPA as appropriate, shall set performance and quality standards for equipment, and may set certification requirements.	As of late January, Treasury hoped to issue guidance in early February. Treasury released a draft tax form to be finalized in February.	Guidance issued February 21, 2006.
Appliances	Secretary, in consultation with DOE, may require information or certification.		No guidance contemplated.
Fuel cells and microturbines	Secretary, after consultation with DOE, may prescribe performance and quality standards for business credit. Technical guidance is needed, for example on how the fuel cell efficiency is measured.	Treasury has indicated they do not plan to issue guidance.	No guidance contemplated.
Hybrid and diesel vehicles	Secretary shall promulgate such regulations as necessary. Secretary in coordination with DOT and EPA shall prescribe regulations to determine eligibility. Secretary to provide guidance to manufacturers on certifying incremental cost for HDVs, including procedures and methods for calculating fuel economy savings and incremental hybrid costs. Secretary shall, by regulations, provide for recapture if ceases to be eligible.	Treasury issued guidance on the hybrid and diesel vehicle credit for light-duty vehicles in January. The guidance explicitly did not address more difficult issues for heavy-duty vehicles or cross-cutting issues such as leases or recapture. The guidance also did not state whether credit information for specific models would be made public. Treasury also released a draft tax form to be finalized in February.	Additional guidance issued June 2, 2006. IRS Form 8910 was released on April 7, 2006.

QFRs – Finance Hearing on FY2007 Budget

Grassley Question 2:

Mr. Secretary, the Senator from New York asked you to confirm or dispute what he called IRS data showing that taxpayers with income of $50,000 or less would receive a benefit of only $11 per return from the lower tax rates on dividends and capital gains, and that the benefit for taxpayers with income of $75,000 would only be $77 per return. I would like to point out that the source of these figures is not the IRS, it is a report done by the Center on Budget and Policy Priorities.

I would like to direct your attention to IRS Statistics of Income, Table 3.6 – 2003, Individual Income Tax Returns with Modified Taxable Income: Taxable Income and Tax Classified by Each Rate at Which Tax Was Computed and by Marital Status. This table shows that, based on IRS estimates of 2003 individual income taxes, 9,833,227 returns reported $33,552,373,000 of dividends or capital gains taxed at 5%. These taxpayers would have been in the 10% or 15% tax brackets, which mean they would have had taxable income less than $50,000. Had those taxpayers been taxed at 10%, their taxes would have been higher by $1,667,619,000. So that means, on a per return basis, these taxpayers saved about $171 each. In 2008, the tax rate is reduced from 5% to 0% for these taxpayers. Based on this 2003 data, which is the most recent data available from the IRS, allowing that rate to expire would result in a $341 tax increase on each of almost 10 million taxpayers in the two lowest income tax brackets.

Mr. Secretary, would you please comment on whether this analysis is consistent with the available IRS data.

Answer:

The averages you cited from a report by the Center on Budget and Policy Priorities appear to be projections for 2009 of the total tax reduction on dividends and capital gains for all taxpayers in the $0 to $50,000 and $50,000 to $100,000 income classes divided by the total number of taxpayers in those income classes – whether or not they have any dividend or capital gains income. Since that report was not produced by the Treasury Department, we are not in a position to verify its accuracy. The averages would be considerable higher, of course, for those who report dividends and/or capital gains.

The averages from the IRS Statistics of Income (SOI) data represent the total tax reduction on dividends and capital gains taxed at the 5 percent rate divided by the number of taxpayers who actually receive dividends and capital gains taxed at the 5 percent rate. Since only a portion of taxpayers with low and modest incomes receive dividend and capital gains income, the average tax decrease for those who do receive such income will be larger than the average for all taxpayers in the given income class. Although the two different averages you cite appear to be consistent, we believe that it is more relevant to discuss the impact of a tax change on those actually affected by it – as the SOI estimates do – rather than the average impact for a mixture of taxpayers most of whom are not affected at all because they do not have any income from dividends or capital gains.

Moreover, it is very important to note that the lower tax rates on dividends and capital gains broadly benefit all individuals who own stocks, regardless of whether they are taxable. The SOI data discussed above do not include taxpayers who hold corporate equities through tax-preferred IRAs or 401(k)s. About 57 million or 50 percent of all Americans own stock in some form and they all benefit to the extent the lower tax rates on dividends and capital gains increased equity values. As the President indicated in his remarks when signing the Tax Increase Prevention and Reconciliation Act of 2005, the lower tax rates on dividends and capital gains helped add about $4 trillion in new wealth to the stock market.

QFRs – Finance Hearing on FY2007 Budget

From Senator Baucus:

Baucus Question 1:

As you know, I have been seeking full repeal of the alternative minimum tax, or AMT, along with a number of my colleagues, including the Chairman. I was successful in modifying the Senate reconciliation bill from an earlier version so that not one additional taxpayer pays AMT this year over last year. But the President's budget comes up short on such protection for working families. As I calculate it, your budget would mean more than a million new families would be paying AMT this year over last year. And the only solace they have is to wait for fundamental tax reform. Were you aware that your budget contained a stealth tax increase on a million taxpayers?

Answer:

Until fundamental tax reform is addressed, we must try to insure that the AMT does not affect a substantially greater number of taxpayers. Together with the Congress, we have provided some form of relief from the AMT in every major tax bill enacted over the past six years to prevent a significant increase in the number of taxpayers affected by the AMT. The Administration's proposal to extend for 2006 the higher AMT exemption amounts and continuing to allow personal tax credits to be deducted for AMT purposes would have accomplished that goal. The Administration is pleased with the enactment of the AMT relief contained in the Tax Increase Prevention and Reconciliation Act of 2005.

We have long recognized the problem of the AMT. The Administration believes, however, that because of the complexity of our tax system, the interrelationship between many of its provisions, and budgetary considerations, the long-term AMT problem should not be dealt with in isolation. Rather, solutions to the problems associated with the AMT over the longer term should be developed in the context of overall changes to the Federal tax system.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 2:

I was pleased to hear President Bush emphasize the need to improve our nation's economic competitiveness in his State of the Union address. I have focused on our economic competitiveness for quite some time and am now introducing legislation to implement my agenda. Improving our competitiveness will require difficult choices and dedicated cooperation. What specific initiatives will the Treasury Department undertake to fulfill this agenda?

Answer:

- Our commitment to maintaining and improving the Nation's competitiveness is strong, and our American Competitiveness Initiative (ACI) is a significant multi-year effort.

- ACI doubles the federal commitment to the most critical basic research programs in the physical sciences over the next 10 years in key federal agencies that support basic research programs in the physical sciences and engineering – the National Science Foundation (NSF), the Department of Energy's Office of Science (DoE SC), and the Department of Commerce's National Institute of Standards and Technology (NIST). The FY07 Budget includes $137 billion for Federal research and development, an increase of 50 percent over 2001. The sum of the budgets of the key agencies will double over 10 years, a total commitment of $50 billion of new funding.

- To encourage bolder private-sector investment in technology, the President continues to support making the research and development (R&D) tax credit permanent.

- To prepare our citizens to compete more effectively in the global marketplace, the ACI proposes $380 million in new federal support to improve the quality of math, science, and technological education in our K-12 schools. Examples include: (1) the Advanced Placement/International Baccalaureate (AP/IB) Program expands access of low-income students to AP/IB coursework, (2) the Adjunct Teacher Corps encourages up to 30,000 math and science professionals over eight years to become adjunct high school teachers, and (3) Math Now for Elementary School Students and Math Now for Middle School Students.

- To help workers make transitions between jobs or to find new jobs, the ACI includes Career Advancement Accounts (CAA) -- self-managed accounts of up to $3,000 that workers and people looking for work can use to obtain training and other employment services. The CAA initiative offers training opportunities to 800,000 workers annually, more than tripling the number trained under the current system.

QFRs – Finance Hearing on FY2007 Budget

- The President's comprehensive plan for immigration reform meets the needs of a growing economy, allows workers to provide for their families while respecting the law, and enhances homeland security by relieving pressure on the borders.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 3:

Based on the most up-to-date data that Treasury has, what is your estimate of when we will reach the debt limit, even after all "extraordinary measures" have been used?

ANSWER:

- Mid-March 2006 remained Treasury's central forecast for when we would have used all extraordinary measures. This underscores why it was important that Congress acted promptly to raise the debt ceiling.

Baucus Question 4:

You have called our current account deficit a "sign of strength" of our economy. We are on track to reach a 2005 current account deficit of $780 billion, another record. Do you still assert that this is a sign of strength, rather that a sign of a fundamentally unbalanced economy?

Answer:

- We continue to monitor the current account and are sensitive to the concerns raised about whether it is sustainable. However, we believe that, overall, the large current account deficit reflects the attractiveness of the U.S. economy and its superior performance relative to other countries over the last several years.

- The current account deficit suggests that U.S. investment in capital to raise our productivity exceeds U.S. saving. The current account deficit has been growing over a decade because growth-enhancing policies in the United States have made it more attractive than other places to invest.

- The U.S. current account deficit is matched by a surplus of the rest of the world. So reducing the U.S. deficit (lowering the surpluses in the rest of the world) is a shared responsibility. The adjustment of global imbalances must be undertaken in a way that maximizes sustained global growth. Against this background, all major economies must play a role.

- In the United States, we're doing our part. Our fiscal policies are aimed at increasing public sector saving (lowering the federal deficit), and we're on track to cut the deficit in half by 2009.

- In Europe and Japan, we'd like to see policies for further structural reforms that boost sustainable growth.

- In emerging Asian economies, we'd like to see greater exchange rate flexibility,

- Finally, we'd like to see an ambitious outcome from the Doha Round of trade talks, which we think is essential to enhancing global growth.

- Our chief danger is that we can hurt the U.S. economy by pursuing protectionist measures. We need to, in partnership with major economies, narrow the current account deficit while maintaining sustained growth both in the U.S. and abroad.

Baucus Question 5:

The IRS is chiseling away at the improvements in taxpayer services that we saw a few years ago. Tele-File, used by 4 million low-income taxpayers, has been eliminated. The IRS has tried to close down Taxpayer Assistance Centers and cut back on telephone assistance hours. I am very concerned that the poor, rural, elderly, and those who don't speak English as a first language, are getting the short end of the stick on services, meaning they might make mistakes or not get the credits, like the Earned Income Tax Credit, that they are entitled to. On several occasions, the IRS has announced plans to cut services before informing this Committee and others here on the Hill. Why is this? Are there any plans to make further cuts in taxpayer services this year? Do I have your assurance that you will tell us about them before, rather than after, you make any decisions? Why did the Administration eliminate the Tele-File program?

Answer:

Although the IRS has shifted some taxpayer services in recent years due to changing customer demands and budget constraints, by all measures taxpayer service has improved in the past several years. Taxpayers expect that the IRS will use its allocated resources wisely while continuing to provide the best service possible. Consistent with that expectation, the IRS decided to eliminate the TeleFile program due to declining use of the program by taxpayers, declining use and shutdown of state TeleFile programs, and the growth of the other electronic filing options, such as Free File. When these factors were balanced against the increasing costs of maintaining the TeleFile infrastructure, it was determined that maintaining TeleFile was not warranted. Another factor supporting elimination of TeleFile was the Electronic Tax Administration Advisory Committee's (ETAAC) formal recommendation in their June 2004 report to discontinue TeleFile.

Baucus Question 6:

The deficit estimates in the President's Budget do not include the costs of the war in Iraq and Afghanistan beyond the FY 2007 supplemental being proposed. The deficit estimates also omit any costs of fixing the AMT in FY 2007 and beyond. And finally, the deficit estimates include outyear estimates for non-security discretionary programs that assume unrealistically low growth rates. Isn't it true that if the costs of the war beyond the FY 2006 supplemental and the costs of fixing the AMT are included, and growth rates equal to the growth rates in the baseline were used for the outyears for non-security discretionary spending, the deficit estimates in the Budget would be significantly higher?

Answer:

- We have specifically excluded the costs of the war in Iraq and Afghanistan beyond our supplemental request for FY2007 because these costs are unpredictable and certain to be highly variable. It would be poor budgeting practice to build these costs into our baseline spending.

- We believe our non-security discretionary program projections are reasonable. In the 2006 budget, the President proposed to hold overall discretionary spending below the rate of inflation, he proposed an actual cut in the non-security portion of discretionary spending, and he proposed major reductions in or the elimination of 154 programs that were either not working or not essential.

- We largely met those goals in 2006, with the help of the Congress. We lowered real discretionary spending, cut nominal non-security discretionary spending and saved \$6.5 billion through reductions or terminating 89 of the 154 targeted programs. Spending restraint is an essential feature of our fiscal plan.

- On AMT reform, we believe that, because of the complexity of our income-tax system, the interactions between the AMT and many other provisions of the ordinary income tax, and the large amount of revenue from the AMT, a permanent solution for the AMT problem must be addressed in the context of fundamental tax reform.

- Last fall, the President's Advisory Commission on Federal Tax Reform submitted its report, and, at Secretary Snow's request, the Treasury Department staff is analyzing its recommendations and developing recommendations for the President.

- The Administration looks forward to working with the Congress to enact tax reform.

Baucus Question 7:

In the IRS Restructuring and Reform Act of 1998, Congress set a goal for IRS of 80% electronic filing by 2007. **a).** Is the IRS going to reach this goal? **b).** If not, why not? **c).** The IRS recently signed a new contract with the Free-File Alliance that reimposed income limits and even some age limits. Last year, when these limits were lifted by most of the vendors, the Free-File rate went up 47% - almost by half. With this kind of growth when Free-File was available to everybody, why did the IRS take a step back and put limits on income or age in the new contract? **d).** Why do you let the vendors sell Refund Anticipation Loans when the effective interest rate is so very high? **e).** Why can't all taxpayers file their tax returns over the internet for free? **f).** After last year's filing season, in order to save just $18 million IRS discontinued the Tele-File program that 4 million lower income taxpayers used to file their tax returns. In an IRS survey, 37% of those people said they would probably go back to filing paper returns. Why did IRS eliminate the Tele-File program? **g).** Why did you agree with the decision to stop Tele-File? **h).** What benefits will the government reap from canceling this program? **i).** Do you think that's a step in the right direction when IRS already is behind pace toward meeting the 80% e-file goal? **j).** Is there a risk that those taxpayers just won't file at all?

Answer:

a). In 2005 (Tax Year 2004), IRS received 52% of all individual returns electronically, an increase of 8.3 million over the previous year. The IRS Restructuring and Reform Act (RRA), set a goal of having at least 80 percent of all tax and information returns filed electronically by 2007. Steady, sustainable progress toward that goal is being made, as the following chart illustrates.

Tax Year	# of Electronic Tax Returns
2004	61,249,038
2003	52,944,000
2002	46,890,000
2001	40,245,000
2000	35,381,000
1999	29,346,000
1998	24,580,000
1997	19,136,000
1996	14,968,000

b) Significant challenges remain in transitioning from a paper-based filing environment to an electronic-based environment. IRS's E-Strategy for Growth outlines a plan to reduce taxpayer burden and meet Congress' 80% electronic filing goal. Key strategies include:

- Make electronic filing, payment and communication simple, inexpensive and trusted, so that taxpayers will prefer these to calling and mailing.

- Substantially increase taxpayer access to electronic filing, payment and communication products and services.
- Aggressively protect transaction integrity and internal processing accuracy.
- Deliver the highest quality products and services as promised.
- Partner with states and other governmental entities to maximize opportunities to reduce burden for our common customer base.
- Encourage private sector innovation and competition.

To achieve these strategic goals, the IRS will continue to develop and implement e-file marketing strategies, expand the use of electronic signatures, and enhance IRS web site services for both practitioners and taxpayers. Ultimately, the goal of the Service is to offer all taxpayers and their representatives the ability to conduct nearly all of their business with the IRS electronically.

c) In October 2005, the IRS and the Free File Alliance (the Alliance) extended their partnership to provide free federal online tax preparation and e-file services to American taxpayers. The new agreement contains important consumer protections and seeks to focus on providing free filing services to those taxpayers least able to afford them and most likely to use them.

During negotiations for the current four-year agreement, the IRS and Alliance agreed that to best serve taxpayers and ensure the long-term stability of the Alliance, the program would focus on covering the taxpayers least able to afford tax preparation and e-filing of their returns on their own.

For the term of this agreement, the Alliance guarantees coverage to 70% of individual taxpayers, which includes all taxpayers whose AGI is $50,000 or less. To maintain this coverage level, we may have to adjust the AGI annually due to changes in the economy and the tax law. Each Alliance member can set its own criteria for free filing eligibility, nearly 93 million taxpayers are eligible to use at least one of the Alliance member's products.

This new agreement allows taxpayers who most need free filing services to get them. It also ensures that the 3 million individual taxpayers who used Telefile in the past have a free electronic filing option. The agreement enables Alliance members to customize offers to taxpayers most suited for their software and ensures that Alliance members remain competitive and innovative in the software industry.

d) The IRS recognizes that refund anticipation loans (RALs) are a standard financial product which may be offered by Alliance members. Although RALs may raise consumer protection issues, the IRS has no regulatory jurisdiction over lending practices.

Under the new agreement, Alliance members offering RALs agreed to include these added features reflecting enhanced standards of consumer protection:

QFRs – Finance Hearing on FY2007 Budget

1. No offer of free return preparation and filing of an electronic return in the Free File program shall be conditioned on the purchase of a RAL.

2. RALs may only be offered in a manner consistent with all statutes and regulations, as well as any guidance issued by the Department of Treasury or the IRS.

3. RALs will be offered with clear language indicating that:

   (a) They are loans, not a faster way of receiving an IRS refund;
   (b) They must be repaid even if the IRS does not issue a full refund;
   (c) That because RALs are short-term loans, interest rates may be higher than some other forms of credit and consumers may wish to consider using other forms of credit; and,
   (d) The time frame in which tax refunds are typically paid is based upon the different filing options available to the taxpayer including the different options that taxpayers have to receive a refund directly from the government (paper check versus direct deposit).

4. No RALs will be made unless consumers affirmatively consent in advance to receiving a RAL. The refund loan facilitator must disclose the expected time within which the loan will be paid to the taxpayer if such loan is approved. No RALs will be made unless consumers affirmatively consent to the disclosure of any personal data in accordance with 26 U.S.C. §7216 with financial institutions making a refund loan.

5. RALs may be offered only as one option among options including a no-added-fee refund from the IRS. The IRS refund option shall be presented first.

6. RALs may be offered but not promoted. A taxpayer may only be asked once if they are interested in a RAL.

7. Some Free File Alliance firms will not offer RAL products, thus ensuring that consumers have RAL-free filing options.

8. The refund loan facilitator must disclose all fees charged with respect to the refund anticipation loan. Such disclosure must include:

   (a) A copy of the fee schedule of the refund loan facilitator;
   (b) The typical fees and interest rates (using annual percentage rates as defined by section 107 of the Truth in Lending Act (15 U.S.C. 1606)) for several typical amounts of such loans;
   (c) Typical fees and interest charges if a loan is not paid or payment is delayed; and
   (d) The amount of a fee (if any) that will be charged if the loan is not approved.

Taxpayers are under no obligation to purchase any products or services from Alliance members in order to use Free File. IRS clearly communicates this message on the IRS website. Although the IRS does not endorse the purchase of ancillary products or services that participating companies may offer on their commercial websites, obtaining a fee-based product is a decision left to the individual taxpayer.

e). Individual tax software companies can offer unrestricted free services on their own web sites, and some Alliance members independently offer free filing services to all taxpayers. In addition, some software companies that are not Alliance members also offer free filing services to all taxpayers.

f). The IRS's reasons for eliminating the Tele-File program are explained in response to question 3, above.

g). The IRS's reasons for eliminating the TeleFile program are explained in response to question 3, above. As stated, TeleFile was by far the most expensive processing method of the three filing options and its incremental cost was continuing to rise as its usage continued to decline. See the chart below for a cost comparison.

Cost per transaction:

TeleFile	Paper	e-file
$2.63	**$1.51**	**$0.67**

h). Taxpayers and the government benefit from the cancellation of the TeleFile program through lower return processing costs. As mentioned above, we estimate that processing costs for 37% of the Telefile population will drop from $2.63 to $1.51 per return, and 62% will drop from $2.63 to $.67 per return. Even if, contrary to recent trends, the number of TeleFilers doubled, the unit cost of each return would still be higher than paper and e-file returns. In order to be cost-competitive with paper filing, TeleFile would have had to nearly triple its volume. This shows that the technology required to support TeleFile is expensive, making it the most costly filing option, electronic or paper.

i). Despite its initial success, TeleFile use for individual returns declined every year during the last 4 years of its existence. Forms 941 and 4868 TeleFile usage grew slightly, but overall TeleFile volume declined. Although 1 million businesses used TeleFile for their employment tax returns, this represents less than 5% of all Form 941's that were filed. Only 7% of Form 4868's were filed using TeleFile.

In April of 2005, individual TeleFile usage was down 13% (475,000) from 2004 figures. Form 941 usage was up 3% (5,700). These numbers followed trends for prior years.

The IRS spent $3,201,341 on a direct marketing campaign to mail 15,049,532 Individual TeleFile packages for 2004, yet only 25% of taxpayers who received the package actually used the program.

The IRS believes that eliminating TeleFile will not negatively impact the number of electronic tax returns filed. When asked about the elimination of TeleFile, a 2004 e-file

Taxpayer Satisfaction study shows 62% of the respondents would try another electronic filing option.

Submission Processing Vision Team findings stated that eliminating TeleFile near term would reduce e-file penetration by 2% at the most, with the expansion of Free File and the increasing Internet penetration rate. In the long run, the e-file penetration rate will recover the 2% lost from eliminating TeleFile.

More than 75 % of tax year 2004 Telefile users have access to the Internet, providing them with an excellent opportunity to take advantage of other free or low cost electronic filing options, such as Free File. In addition, Volunteer Income Tax Assistance (VITA), and Tax Assistance Centers (TAC) continue to offer free Tax preparation and e-file.

j). No, based on surveys, the risk is that they would switch to a paper return initially. Findings showed that as users leave TeleFile they are more likely to file a paper return the next filing season, but e-file is gaining popularity.

Year	% would switch to paper filing	% would switch to e-file
CY 2000	69	31
CY 2001	69	31
CY 2002	55	45

2003 Individual Survey findings

- Although TeleFilers may revert to paper in the short term (55% in 2002), research indicates that they rebound to electronic filing at a higher rate than the general population.
- 52% of Individual TeleFilers surveyed said that they would switch to e-file if TeleFile was not available.

2003 Business Survey findings

- 46% of Business TeleFilers surveyed said that they would switch to paper, while 51% would seek an electronic filing option.

2004 e-file Taxpayer Satisfaction Study

- 62% would try another electronic method, mainly Free File, while 37% would go back to paper.

As a precaution, we also sent postcards to prior-year TeleFilers encouraging them to file electronically and advising them of their available options.

Baucus Question 8:

I am concerned that the structure of your tax incentives for health care could undermine existing employer coverage. Providing individuals with a tax credit to purchase insurance only if the employer pays nothing is one piece that concerns me. Last year, I asked if you would consider extending the tax credit for individual purchase of HDHP's to small employers who make HDHP's available to employees. You said that would be more expensive and less efficient, because an employer credit for the premium would go to those already providing coverage. Won't employers that provide coverage now be likely to stop paying for coverage to trigger the refundable credit for their lower income employees? Are you not concerned that loss of employer coverage could more than offset gains in individual coverage? The President's tax panel recommended capping the tax benefits for employer-based health plans. They seemed to feel that certain employers provided too generous health benefits and those extra benefits should be subject to tax. The President's budget seems to be going in the other direction. It is bringing all the employer-based tax benefits to the individual. Do you disagree with the Tax Panel's ideas to make certain employer-based benefits taxable?

Answer:

The Administration believes that the tax system should allow taxpayers to make decisions based on economic merit, free of tax-induced distortions. Such distortions exist when those taxpayers without access to employer-provided coverage do not have the same tax advantages as those who have employer health coverage. Of course, one way to address this inequity is to eliminate the tax advantages of employer-provided coverage. We have taken a different approach. We propose to level the playing field for those who have to buy coverage without their employer's assistance. But we level the playing field in a more cost conscious way by encouraging individuals to purchase high deductible plans in combination with an HSA. Because individuals will keep the savings from using more cost effective medical care, they will be less likely to use medical services that are of little value.

Employees will still be very attracted to employers that sponsor coverage because employer-sponsored coverage is generally cheaper than individual coverage. Employers will continue to sponsor health coverage in order to attract a quality workforce. Thus, we believe that the Administration's proposals will increase coverage on net.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 9:

Our goals should be to expand health coverage to the millions of uninsured workers, and find ways to control spiraling health costs. The budget includes an increase in the maximum annual contribution to an HSA. Most of the uninsured cannot afford health coverage, and have not been clamoring for higher contribution limits. Many commentators have said that health is not like other consumer goods. They argue that most individuals do not have the expertise to make informative decisions about health care spending. Further, most health care expenses result from catastrophic costs. How do you expect an increase in the HSA contribution limit to expand coverage or control costs? I am delighted to see that the President has made competitiveness a focus of his budget. I've spent a lot of time discussing the issue. Yet when I look at the healthcare proposals, I don't really see any approach to addressing the U.S.'s highly costly, yet inadequate, healthcare system. How do the President's healthcare proposals fit with his emphasis on improving competitiveness?

Answer:

We share your concern about the affordability of health insurance coverage for low-income individuals. That is why the budget includes a $3,000 refundable tax credit for families that purchase of a high-deductible health plan. Moreover, the budget includes full deductibility—including payroll tax deductibility—for HSA-qualified plan premiums and HSA contributions. Both of these proposals are particularly directed to improve the affordability of health insurance for people with low incomes.

We believe in the potential of high-deductible health plans to reduce excessive expenditures on routine or discretionary care. Raising the HSA contribution limit should make consumers even more cost-conscious about decisions for care while still encouraging comprehensive health insurance take-up. We can all agree that when any policyholder is cost-conscious, everyone in the risk pool benefits. Keep in mind that HSA-qualified plans must have out-of-pocket limits, which are currently set at $5,250 for self-only and $10,500 for families. Thus, people with HSAs are still protected against catastrophic health costs. While HSAs per se do not directly address high catastrophic cost, it is tremendously valuable to put in place incentives to reduce easily identifiable low-value care at low expenditure levels.

We also agree with you that currently information to make informed health care decisions is inadequate, but this is true whether an individual has an HSA-qualified plan or not. That's why the Administration has used Medicare's leverage to collect and disseminate quality information about hospitals and is currently looking at other opportunities in government health programs to further the goal of improving the availability of quality information. We are also encouraging the private sector to take initiative itself in collecting and disseminating quality information. Coupled with more transparent information about prices, which the Administration is also advocating, patients and their doctors will be able to make better informed decisions about their care.

Baucus Question 10:

The IRS Oversight Board was created in 1998 to monitor what the IRS is doing. The Board plays an important role in making sure that taxpayers are treated fairly and get the help they need to file their tax returns. Out of 7 private life member positions on the Board, however, there are 5 expired terms, and 3 of those positions are vacant. How can the Oversight Board do a good job of looking out for taxpayers when so many of the positions are vacant? One of the terms expired in 2003, and several others expired in September of 2005. Why is it taking so long to fill these openings? Why isn't the oversight of the IRS a higher priority to the Administration? Isn't it important to make sure that our tax dollars are being used efficiently and that taxpayers are being treated fairly?

Answer:

On May 1, 2006, the President nominated 4 outstanding individuals to fill the vacant or expired seats on the IRS Oversight Board. They are:

- Paul Cherecwich, Jr., of Utah, to be a Member of the Internal Revenue Service Oversight Board for a term expiring September 14, 2009, vice Charles L. Kolbe, term expired;
- Donald V. Hammond, of Virginia, to be a Member of the Internal Revenue Service Oversight Board for a term expiring September 21, 2010, vice Robert M. Tobias, term expired;
- Catherine G. West, of the District of Columbia, to be a Member of the Internal Revenue Service Oversight Board for a term expiring September 14, 2008, vice Karen Hastie Williams, term expired; and
- Deborah L. Wince-Smith, of Virginia, to be a Member of the Internal Revenue Service Oversight Board for a term expiring September 14, 2010, vice Larry L. Levitan, term expired.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 11:

The latest IRS figures estimate the tax gap, the difference between what taxpayers owe and what they pay, at $350 billion per year. Per year. Our nation's deficit is estimated to be $400 billion. It doesn't take a rocket scientist to figure out that closing the tax gap will help to close our deficit. **a).** What is the Administration doing about the tax gap? Give me some examples of specific actions you are taking to close the gap. **b).** What role do you think taxpayer services play toward closing the gap? **c).** This year's proposed IRS budget is even less than last year's after you take inflation into account. Since the gap seems to grow larger, not smaller, how is the IRS supposed to make headway against the gap with less? **d).** The 2001 study only covered individual underreporters and a current study covers Subchapter S shareholders. What about those folks who don't file any tax return at all – the "cash economy"? Do you think they are a significant part of the gap? **e).** When do you plan to do a study on them? **f).** Before the 2001 Tax Gap study came out, it had been many years since a reliable study had been done. Does the IRS have a master plan to conduct regular, ongoing tax gap studies in the future so we always have current and reliable tax gap numbers to know what we are dealing with?

Answer:

a). The Administration is taking several steps to address the tax gap. Most, but not all, of these follow on steps taken in previous years. For example, the IRS is continuing a steady build of its enforcement resources. This should enable the IRS to increase its enforcement presence in several key areas, such as high income individuals and corporations. An increased enforcement presence should lead to improved voluntary compliance, and increase enforcement revenues. The IRS is also improving its service delivery in order to foster compliance among taxpayers trying hard to meet their tax obligations. The President's budget includes several initiatives to encourage voluntary compliance, through increased information reporting and other steps. Finally, the complexity of the tax law contributes significantly to noncompliance. Honest taxpayers having difficulty understanding the tax law can use the technicalities of the law to avoid or evade tax. Consequently, tax reform and the simplification it will bring, is a very effective way to reduce the size of the tax gap.

b). Taxpayer services, such as education, outreach, answering account and tax law questions, and providing forms, instructions, and other resources, support the IRS mission by fostering greater voluntary compliance. They do so by clearing up misunderstandings and alerting taxpayers to their tax obligations under the law. These activities therefore prevent noncompliance before it happens, which is better for taxpayers and for the IRS. Most taxpayers want to meet their tax obligations in a timely manner, so taxpayer services like these are crucial in a balanced administration of the tax laws.

c). The President's Budget proposal reduces overall spending on non-defense, non-Homeland Security discretionary programs. The IRS is an exception to the overall trend. We believe that the President's budget request, in conjunction with finding efficiencies within the Service's operations, provides a sufficient level of resources to appropriately administer the Nation's tax laws. Combined with the tax proposals included in the President's budget, the modest increase in overall enforcement resources should allow the IRS to make progress on reducing the size of the tax gap.

d). Much of the underreporting gap is associated with individuals who earn income in a cash-based business, but under-report (or do not report) it on their return. This is not the same thing as the "cash economy," which is not directly reflected in the IRS's recent update to the estimate of the tax gap. Individuals who under-report cash income often file returns that report income covered by third-party information reporting (such as wages from a regular job, interest, dividends, etc.) and report only some of their business income. The cash-based income that is not reported may be from moonlighting or other secondary activities. Our updated estimates of the individual income tax and self-employment tax underreporting gaps include this component of the legal-sector "cash economy" based on data from the National Research Program study of Tax Year 2001 individual income tax returns.

Individuals who derive much of their income from cash-based business activities also contribute to the nonfiling gap. The IRS recently updated its estimate of the individual income tax nonfiling gap. This estimate ($25 billion) is similar to what the IRS had projected from much older nonfiling data, and it includes individuals other than those who participate in the "cash economy" as well as some who did. By way of comparison, the portion of the underreporting gap due to understating non-business income is twice as large, and the portion of the underreporting gap due to understating business income is four times as large as the IRS's estimate of the nonfiling gap related to individuals. This suggests that although nonfiling is a serious problem, the scope of the problem is reduced by the presence of third-party information documents, which prompt many individuals to file returns, even if they do not report all their cash-based income.

e). Until recently, the IRS used data from the Census's Current Population Survey to update its nonfiling gap estimate, the IRS's estimates were based on a Tax Year 1988 IRS study of individual nonfilers. The 1988 study focused on a random sample of Social Security Numbers that were not accounted for on filed returns and could not be accounted for in any other way (e.g., children, death, etc.). The IRS attempted to contact the individuals in the sample to determine if they had a filing requirement and, if so, to secure a delinquent return. Those returns were then audited in detail to determine their tax liability, and became the basis for our nonfiling gap estimates. Although that approach has some advantages, it also has important disadvantages: many of the individuals could not be contacted, many of those who were contacted did not file delinquent returns, and the study was extremely labor-intensive, and therefore costly. The indirect approach using Census data had been used prior to that study, and the IRS decided to rely on that approach again more recently. Given the relative magnitudes of the gaps involved and the shortage of IRS enforcement resources to conduct research studies, we have no plans to conduct another nonfiler study like the 1988 study in the foreseeable future.

f). The IRS is committed to on-going research into the size and causes of the tax gap. We currently have in place mechanisms to provide regular measurements of the individual income tax filing rate and the underpayment gap for all types of tax on an annual basis. The National Research Program (NRP) office has coordinated the implementation of two separate reporting compliance studies: the recently completed Tax Year (TY) 2001 individual income tax study, and the subchapter S corporation study now underway. The NRP office is working with internal and external stakeholders to develop a schedule of future reporting compliance studies. Naturally, this schedule will depend quite a bit on the evolving information needs of IRS business units.

Baucus Question 12:

I know you are still studying the recommendations from the tax reform panel before you forward your own to the President, but I wanted to discuss with you one item that has concerned me. More than 70% of Montanans own their own home and I was really surprised to see a proposal that would scale back on the home mortgage interest deduction, particularly since the President singled it out for special status when he created the panel. I wonder if you could clarify for this Committee whether you believe you will endorse this proposal as well. I have already heard from a number of advocates in the real estate market who are nervous about the potential impact. Can you tell us whether this proposal is still under serious consideration or has it been taken off the table? And, if it is still under consideration, do you have any advice for potential homeowners who may be deciding whether to purchase or not?

Answer:

When the President's Advisory Panel on Federal Tax Reform delivered its final Report to me last November, the Panel's recommendations included some changes in the tax treatment of home mortgage interest. Those recommendations are currently under study, but President Bush has stated that a preference for home ownership will continue to be part of our income tax code.

The Administration strongly supports widespread homeownership, and the President is very proud of the increase in homeownership, particularly among minorities, since he has been in office. The homeownership rate is near its all time high. We certainly do not intend to take actions that will adversely affect homeownership.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 13:

I was troubled to see the front page of USA today on Monday, January 30 which had the headline "FEWER TERROR ASSETS FROZEN". As you know, the Senate Finance Committee has raised questions about the anti- terrorism financing effort in your administration and this headline heightens our concern. The story quotes Jimmy Gurule, a former Treasury Department undersecretary for enforcement, saying that there is a "lack of urgency" in the anti-terrorism financing effort. He notes that after 9/11 $68 million in terrorist assets was frozen over the course of 4 months. Yet the total amount frozen for 2005 was only $4.9 million. We continue to worry about who in this administration is leading the terrorism financing effort - at one point it was led by the Treasury Department, but now it appears that the National Security Council is in the lead. Many question whether the NSC is really coordinating the effort in an effective way. Finally, we are concerned about whether the Treasury Department has the resources it needs to track down terrorist assets. Please give me your view of how the TFI office is faring and your reaction to the USA Today story.

Answer:

The Treasury Department has no higher priority than our national security, and our efforts to combat terrorist financing continue to receive our utmost attention. Indeed, we are doing more today than ever before to stem the flow of funds to terrorists, attacking the problem from every angle. Our Office of Intelligence and Analysis is aggressively tracking terrorist money flows using all available data, with experts in financial intelligence scrutinizing the flow of funds from donor to terrorist cell. Using this information, we draw upon all of our diplomatic, administrative, regulatory, and enforcement tools to disrupt or disable individual terrorist financiers. Depending on the case, our office and the interagency terrorist financing team may designate a financier under U.S. or United Nations authority, take law enforcement action, work with our allies abroad to support foreign administrative or law enforcement action, or simply monitor the target to facilitate further intelligence collection. On a systemic level, we are working with our allies and the private sector to increase transparency and accountability in the international financial system, at home and abroad. The NSC has played an effective role in ensuring that our interagency efforts are directed in a coordinated and strategic manner.

All of these efforts have only increased in intensity over time, enabling us to make substantial progress in impeding, isolating and incapacitating those who would support terror. Our intelligence efforts are today more adept, better coordinated, and better staffed, yielding sophisticated analyses of the ways that terrorists move money and the choke points that are vulnerable to disruption. Our international efforts to promote targeted sanctions have borne fruit, as we have witnessed country after country stepping forward for the first time to target supporters of al Qaida or the Taliban for designation at the United Nations. Systemically, there has been a revolutionary transformation of public and private counter terrorist financing regimes, making it harder for terrorists to move and store their money, and making it easier for us to catch them when they do.

The referenced USA Today story reports that the amounts of assets frozen have decreased. This is to be expected, and far from a negative sign. Having learned from experience, terrorists have become more cautious in how they move and store their money, including moving money in smaller batches and transferring money outside of the formal financial system altogether, by means of hawalas and cash couriers. These represent successes in and of themselves, as terrorist facilitators confront greater costs, risks, and inconvenience than they once did. To provide one example, cash couriers are a poor substitute for a bank transfer – some couriers get caught, and some get greedy. A front-page story in the USA Today from earlier this week reported on our successes in this arena. (See "Terror Funding Shifts to Cash," USA Today, A1, June 18, 2006). For this reason, we do not look to the amounts of blocked funds as an indicator of our progress.

By all reliable accounts, we are doing exactly what this Committee and the American people expect of us – creatively and aggressively deploying all of our authorities against terrorist financiers, however they seek to move money. And we are meeting with success. The 9/11 Commission's Public Discourse Project reviewed our government's overall counter-terrorism efforts with a critical eye. They awarded only one "A-," which went to our efforts to combat terrorist financing, noting that "[t]he government has made significant strides in using terrorism finance as an intelligence tool."

The metric that we pay most attention to, however, is the bottom line – have we made it more difficult for terrorists to fund themselves? The answers we get are necessarily fragmentary and difficult to describe publicly. But we continue to see encouraging reports about terror cells that are desperate for cash, and terrorist leaders who don't have enough money to provide allowances to their members and their families. In recent months, we have seen at least one instance of what we look for most – a terrorist organization indicating that it cannot pursue sophisticated attacks because it lacks adequate funding.

We have also made dramatic progress in combating terrorist abuse of charities. Prior to 9/11 and even afterwards, terrorists used charities as safe and easy ways to raise and move large sums of money. Al Qaida and Hamas, in particular, relied on charities to funnel money from wealthier areas to conflict zones with great success. Through a combination of law enforcement and regulatory actions against several corrupt charities, both at home and abroad, we have taken out key organizations and deterred or disrupted others. In tandem, active engagement with the legitimate charitable sector has succeeded in raising transparency and accountability across the board.

We have thus far designated more than 40 charities worldwide as supporters of terrorism, including several U.S. charities such as the Holy Land Foundation, the Global Relief Foundation, the Benevolence International Foundation, the Al Haramain Islamic Foundation, and the Islamic African/American Relief Agency (IARA). The impact of these actions is serious, and sometimes decisive. IARA once provided hundreds of thousands of dollars to Osama bin Laden. More recently, IARA country offices have found themselves under increased pressure and IARA's leaders have expressed concern about the organization's future.

There is much work still to be done, but we remain committed and will do everything in our power to undercut terrorists and their deadly goals.

Baucus Question 14:

The President has made tax reform a big legislative priority. He created a Tax Reform Advisory Panel last year. He also made mention of improvements to the tax code his State of the Union Address last week. It has been 2 years since there has been an Assistant Secretary for Tax Policy. How can this Administration possibly be serious about tax reform when the position most central to promoting the President's tax agenda has remained vacant for two years? How can you take a hard look at the code and make intelligent changes when the tax policy office of the Treasury is empty?

Answer:

Tax reform is an important goal that must be achieved in a workable and realistic time frame. The Office of Tax Policy has been fully engaged on the issue, providing substantial support to the President's Advisory Panel on Tax Reform and separately considering reform options. The Office of Tax Policy is continuing to evaluate the Tax Panel's recommendation and consider options for reform.

The Treasury Department is currently in the process of filling staff vacancies in the Office of Tax Policy and the Administration recently forwarded a nominee to the Senate Finance Committee for the position of Assistant Secretary for Tax Policy.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 15:

Last week I was glad to be a part of the U.S.-South Korea free trade agreement launch. I have been advocating that agreement for seven years. This initiative is just one of many. USTR has completed seven agreements in just the past few years, which it must now monitor and implement. We just completed two more agreements, at least two more are planned, and at least six more are in process. And one of the administration's key goals this year is to complete the WTO Doha Round. I'm afraid that we're starving USTR – and that our ambitious trade agenda will suffer for it. What are the administration's funding priorities for USTR? Will the administration increase USTR's already meager budget?

Answer

- As a rule, Treasury does not comment on USTR budgets.

Baucus Question 16:

You recently remarked that real (inflation-adjusted) wages had risen 1.1% since March 2001 in contrast to the 2.1% decline in wages over a comparable period of the 1990s business cycle. However, recent news tells a difference story. Wages and benefits for workers rose last year at less than the rate of inflation for the first time in almost a decade. Total compensation paid to civilian employees jumped 3.1 percent last year, while the costs of goods and services grew at 3.4 percent, according to the Labor Department. When inflation is considered, worker compensation fell 0.3 percent, marking the first decline since 1996. What is the administration's plan to allow average workers the opportunity to share in our recent economic growth?

Answer:

- Average workers are sharing in our recent economic growth. Since August 2003, when employment reached its low point following the recession, the economy has gained almost 5.3 million new jobs. These employment increases represent jobs for those previously unemployed and new labor entrants. That's a big improvement.

- It's true that real average hourly earnings fell 0.6 percent in the year ending May 2006. But nominal earnings are averaging about 3.5-to-4 percent growth, which is well above wage growth from 2002-2004. The key reason for the decline in real terms has been the surge in energy prices, which raised the overall CPI.

- Overall, as I have stated before, real compensation – wages plus fringes -- have performed better in the past five years than in the same period of the previous business cycle.

- Also, I believe you are using the employment cost index to measure compensation paid to civilian employees. The ECI has many fine uses, but it should be noted that it uses fixed weights for jobs, so that if workers are moving into better jobs the wage gains associated with such movements are not reflected in the index.

- Going forward, we're confident that we're moving to a part of the business cycle in which the labor share of output is going to rise. That increase is part of our Mid-Session Administration forecast and the CBO's January forecast.

- Still there is more work to be done. We're working to reduce our dependence on foreign oil, which will help shield workers from rising prices for foreign oil, which act as a tax on U.S. earnings.

- We're helping workers to make transitions between jobs or to find new jobs. Our American Competitiveness Initiative includes Career Advancement Accounts (CAAs), which are self-managed accounts of up to $3,000 that workers and job seekers can use for training and other employment services.

- We're working to make our growth-enhancing tax cuts permanent so that we continue to grow the economy, giving workers the opportunity to earn more.

Baucus Question 17:

The Administration's legislative proposals to close the tax gap are estimated to raise $3.5 billion over 10 years. However, the annual tax gap, spread over 10 years, is estimated to be $3.5 trillion. Why are the Administration's proposals so inadequate? Why did you stop at $3.5 billion when the tax gap is 1000 times bigger? Do you really think this will make a meaningful dent in the tax gap?

Answer:

In March 2005, the IRS released preliminary results from a major new research project assessing compliance with the tax laws by individual taxpayers. The preliminary results were updated in February 2006 and show that the gross tax gap, which represents the difference between the amount of tax that should be paid and the amount that is actually paid on a timely basis, was approximately $345 billion for tax year 2001. This amount is reduced by late payments and collections to a "net" tax gap of approximately $290 billion.

The IRS's research project confirmed that the vast majority of Americans pay their taxes timely and accurately, but also confirmed that a significant gap persists between what taxpayers should pay in taxes and what they actually pay on a timely basis. The Administration's Budget makes five proposals that, if enacted, would help to address the tax gap. One of those proposals recommended information reporting and, if necessary, backup withholding for most non-wage payments made by Federal, state, and local governments. The recently-passed reconciliation act enacted that proposal in modified form; it includes three percent withholding on such payments. In addition to these five proposals, the Treasury Department will study the standards used to distinguish between employees and independent contractors for purposes of withholding and paying Federal employment taxes.

The estimate of the tax gap also implies that the level of compliance is at roughly 85 percent. While we need to carefully consider approaches to increase this rate of compliance, it is also important to recognize that compliance can not be increased to 100 percent, and some noncompliance will remain under any tax system. Moreover, when considering measures to improve compliance we need to carefully balance taxpayer service with enforcement.

Finally, a significant cause of the tax gap is the complexity that underlies our tax system. Under the current system, even sophisticated taxpayers who make every effort to comply with the tax laws often have a difficult time doing so. Those wanting to avoid their obligations under the tax law can hide behind the veil of complexity in failing to do so. Until we have fundamental reform of the tax system, however, we need to consider interim steps under the existing system to improve compliance and reduce the tax gap. The Administration's five proposals, while addressing only a small part of the tax gap, are an important step in addressing the problem. The Treasury Department will continue to consider other possible ways to reduce the tax gap, including for example, enhanced enforcement initiatives and increased information reporting.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 18:

The IRS Oversight Board never had an opportunity to review or approve of either the IRS budget or the IRS long-term goals included in the budget justification. The IRS Restructuring and Reform Act of 1998 clearly provide the Board has the specific responsibility for both. Why was the IRSOB cut out of the IRS budget and long-term planning process? How can you justify this when RRA '98 clearly requires that the Board must review and approve both the budget and any strategic plans for the IRS? Please provide your commitment that you will comply with the law next year by giving the Board adequate time to review and approve the FY '08 budget, as well as any strategic plans for the IRS that are included as part of the budget.

Answer:

The IRS Oversight Board reviewed the IRS' FY 2007 Budget request that was submitted to the Department of Treasury in June 2005. Discussions regarding the IRS' FY 2007 budget request began on February 2, 2005, and continued throughout the spring. On April 27, 2005, the Chairman of the IRS Oversight Board sent the Commissioner a memorandum that detailed the Board's need for a review of the IRS budget and a proposed timeline for approving its FY 2007 Budget request for the IRS. The IRS provided the IRS Oversight Board all of the requested information as it became available throughout the month of May; briefed the Board on the FY 2007 Treasury Budget submission on June 2, submitted the request to the Board on June 13, and continued to respond to Board staff questions throughout the formulation of the Board's FY 2007 Budget for the IRS. In late June, the Oversight Board requested additional information for the formulation of three additional initiatives for the Board's consideration. The Board discussed the FY 2007 Treasury budget with the Commissioner at the July Board meeting and, in August 2005, approved the IRS' FY 2007 Budget submission, which incorporated the three additional Board requested initiatives.

The IRS Oversight Board also has the responsibility to review and approve strategic plans, which include long-term strategic goals. The Oversight Board was briefed in May, June, August and September of 2005 on the new, long-term corporate goals included in the IRS' FY 2007 Budget submission. The President's FY 2007 Budget also included a number of long-term program goals for the IRS. These goals were developed to comply with the requirements of both the Government Performance Results Act and OMB's Program Assessment Rating Tool (PART).

The IRS Oversight Board approved the IRS Strategic Plan before it was published in June 2004 and also approved the direction IRS planned to take with respect to development of the five enterprise-wide long-term measures at its September 2005 Board meeting. The IRS' FY 2007 President's Budget included numerical targets for one of the five long-term measures to comply with requirements of OMB's PART. The IRS shared proposed targets for the remaining four measures at the February 2006 Board meeting. The IRS has committed to continue to work with the Board to refine the targets for the four remaining long-term goals at future Board meetings.

The Service is committed to working closely with the Oversight Board in the review and approval of the IRS' FY 2008 Treasury Budget request, the development and refinement of its long-term corporate measures, and the development of its revised strategic plan, which began in early June 2006.

Baucus Question 19:

Section 2004 of the IRS Restructuring and Reform Act of 1998 requires the Secretary to develop a return-free tax system for years after 2007. An annual status report to the Senate Finance Committee and the House Ways and Means Committee also is required. Are you developing a return-free tax system? Provide a detailed status report and the timeline for implementation. If this is not under development, explain why you are not complying with RRA '98. Have you provided annual updates to Congress? If so, please provide copies. If not, why not?

Answer:

In December 2003, the Treasury Department issued a report to Congress, entitled "Return-Free Tax Systems: Tax Simplification Is a Prerequisite." The report found that some taxpayers could potentially be exempted from a filing requirement under the current tax system. But as its title suggests, the report also found that it would be problematic to shift to a return-free system without first simplifying the current income tax system. Exempting taxpayers from a return filing requirement under the current income tax system could shift burdens from some taxpayers to their employers, other businesses, state governments, and the IRS. Even among those eligible to participate in a return-free tax system, compliance costs might not decline significantly if eligible taxpayers currently file relatively simple returns or are reluctant to participate in a return-free system. Without tax simplification, a return-free tax system may not reduce overall compliance and administrative costs. A copy of the December 2003 report is available at the following web site: http://www.treas.gov/offices/tax-policy/library/noreturn.pdf. No other reports have been issued.

The Administration is committed to simplifying the tax code, to make it fairer, more pro-growth, and less burdensome for taxpayers to comply with and for the IRS to administer. As you know, the President appointed a bipartisan Advisory Panel on Federal Tax Reform in January 2005. As part of its considerations, the Advisory Panel heard from experts regarding return-free tax systems in a hearing on May 17th 2005. (The transcript of this hearing is available at the following web site: http://www.taxreformpanel.gov/meetings/meeting-05172005.shtml). However, the Panel's final report, issued on November 1, 2005, did not contain any recommendations regarding filing requirements under their two tax reform options.

The Secretary is currently evaluating the recent recommendations of the bipartisan Advisory Panel on Federal Tax Reform. When the Secretary completes his review of the Panel's report, he will make his own recommendations to the President who, in turn, will make recommendations to the Congress. Before issuing recommendations, the Treasury Department will carefully examine ways to reduce overall compliance and administrative costs, including the appropriate filing requirements under tax reform. If the Administration recommends a tax reform proposal that includes a return-free component, we will report to Congress on the legislative and administrative changes needed for implementation as well as its cost requirements.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 20:

For 30 years, the IRS has been providing statistical information to the Transactional Research Access Clearinghouse. In May of 2004, the IRS ended this practice and said it would cost TRAC $12,000 per month to get it. Why did the IRS abruptly stop giving TRAC this data? Why is it necessary to charge $12,000/month for information that used to be free? IRS says this information could endanger taxpayer privacy. If that's true, then why is IRS willing to sell it to TRAC?

Answer:

We recognize our obligation to provide statistical data on the performance of our tax administration system. We believe the public should have access to statistical data on the examinations we conduct. We include such information in Tables 10 - 13 of our Annual Data Book. The Annual Data Book provides over 30 tables of statistical information on the IRS's prior fiscal performance. We make the Annual Data Book available to the public through the "Tax Stats" link on the irs.gov website, under "Products and Publications." http://www.irs.gov/taxstats/article/0,,id=102174,00.html

In addition to the Annual Data Book, we also publish a variety of reports, tables, and studies. I have enclosed a copy of the printed "Tax Stats" homepage to give you an idea of the breadth of information we make available to the public. Each one of the links on the Home Page provides access to more reports, tables, and studies.

QFRs – Finance Hearing on FY2007 Budget

Baucus Question 21:

On Monday, the IRS announced that they would be making changes to their questionable refund program in order to provide better notice to taxpayers subject to the questionable refund program procedures and address potential flaws in their screening methodology. In particular, the IRS press release states that the Service will take the following steps: "1. Improvements to screening procedures. The IRS will improve and refine the accuracy of filters in the program to reduce the initial number of valid refund claims held. 2. Earlier release of refunds. The IRS will expedite the review of returns, resulting in an earlier release of refunds. 3. Notification to taxpayers. The IRS will notify all taxpayers whose refunds are frozen." What steps will the IRS take to refine their screening system so that it is better positioned to ensnare fraudulent claims while ensuring that honest taxpayers are not flagged? For example, is the IRS planning to get an independent audit of their screening methods in order to identify to what extent the initial screening provides an accurate and reliable fraud filter? How quickly will the IRS act on frozen returns? The Taxpayer Advocate states that returns were held up in some cases for more than a year – how much will the new "expedited review" process speed up the release of legitimate refunds? What type of notification will IRS send out to taxpayers? Phone contact? Mailings? Will they be bilingual? How quickly will notice be sent?

Answer:

This filing season the IRS is implementing new procedures, in partnership with the Taxpayer Advocate, to notify taxpayers that it is freezing their refunds at the time the IRS initiates the freeze. The IRS will also automatically release refunds after an established period of time if it has not determined that a particular return requires additional verification, and it will minimize automatic freezes on taxpayers' accounts in future years.

To improve its return filtering system, the IRS has also recently contracted with the Department of Health and Human Services (HHS) to verify wages for taxpayers who claim the earned income tax credit (EITC). This HHS database, which gives the IRS access to salary data updated quarterly, was not available until this year. Using information from the HHS database will help the IRS release legitimate refunds faster because it automatically verifies wages and withholding credits. This will greatly reduce the number of initial freezes on questionable refund requests that have an EITC component. The IRS continually examines and updates all of its filters used to screen refund requests, and as its systems become more refined, our ability to detect fraud will increase while the effect on legitimate refund claims will decrease. To this end, the Treasury Inspector General for Tax Administration (TIGTA) is currently conducting an audit of our filtering system to assess its effectiveness and identify potential improvements.

In addition, the IRS will refine its identification and selection criteria and review refunds frozen from 2004 and prior tax years. Determining the proper disposition of these cases will require additional time and resources. The IRS will either process the refund or notify the taxpayer to give him or her an opportunity to substantiate the claim. Notices will be mailed to taxpayers and will be written in both English and Spanish. The IRS hopes to have these completed by the end of this year.

Despite the IRS's focus on minimizing error and fraud, it remains committed to maximizing participation among EITC-eligible taxpayers. The IRS works to achieve a balanced approach to administering the EITC that encourages maximum participation among eligible taxpayers while minimizing error and fraud. The IRS has developed numerous tax forms, publications, and other materials to make taxpayers aware of the credit and of the requirements for appropriately claiming it. The IRS has used funding for increased community-based education and outreach efforts that support awareness, provided more return preparation assistance, and enhanced volunteer return preparer education. The IRS has also used funding for a number of EITC business process initiatives that support EITC.

Baucus Question 22:

Your written testimony states, "Tax increases carry an enormous risk of economic damage and I can tell you today that the President will not accept that risk. He will not accept a tax increase on the American people." However, the budget submission only requests an extension for one year of the 2005 exemption level to protect taxpayers from the Alternative Minimum Tax (AMT). This would leave at least one million working taxpayers with a tax increase in 2006 because of higher taxes under the AMT. For 2007, more than 20 million taxpayers would see a tax increase because of the AMT. How do you reconcile your statement that the President will not accept tax increases and the fact that the budget recommends a tax increase on a million taxpayers?

Answer:

Until fundamental tax reform is addressed, we must try to insure that the AMT does not affect a substantially greater number of taxpayers. Together with the Congress, we have provided some form of relief from the AMT in every major tax bill enacted over the past six years to prevent a significant increase in the number of taxpayers affected by the AMT. The Administration's proposal to extend for 2006 the higher AMT exemption amounts and continuing to allow personal tax credits to be deducted for AMT purposes would have accomplished that goal. The Administration is pleased with the enactment of the AMT relief contained in the Tax Increase Prevention and Reconciliation Act of 2005.

We have long recognized the problem of the AMT. The Administration believes, however, that because of the complexity of our tax system, the interrelationship between many of its provisions, and budgetary considerations, the long-term AMT problem should not be dealt with in isolation. Rather, solutions to the problems associated with the AMT over the longer term should be developed in the context of overall changes to the Federal tax system.

QFRs – Finance Hearing on FY2007 Budget

From Senator Rockefeller:

Rockefeller Question 1:

The President's fiscal year 2007 budget includes two main proposals allegedly aimed at increasing health insurance coverage – individual tax credits and the expansion of Health Savings Accounts (HSAs). How many currently uninsured Americans do you estimate each of these initiatives will cover? What is the basis for your estimates?

Answer:

There are two mechanisms through which the administration's health care proposals will encourage the uninsured to purchase health insurance. First, the HSA expansions will lead to a greater number of High Deductible Health Plans (HDHPs). Indeed, the Treasury Department estimates that these proposals would increase the number of HSAs by 50 percent, from 14 million in 200X to 21 million in 200X. HDHPs provide consumers with a much larger role in health care by requiring that the consumer bear a larger share of the financial responsibility for his or her health care decisions, thus bringing market forces to bear on the cost of medical expenditures.

Moreover, the President's HAS-expansion proposal includes a refundable income tax credit that would, through the income tax system, refund the payroll taxes paid on the portion of wages spent on health care. This provides a significant incentive to low income individuals to purchase health insurance. Second, the Health Insurance Tax Credit (HITC) provides a significant subsidy to low income individuals for the purchase of HDHPs.

QFRs – Finance Hearing on FY2007 Budget

Rockefeller Question 2:

According to the Kaiser Family Foundation, the average annual premium paid for single individually-purchased coverage was $1,786 and $3,383 for family individually-purchased coverage in 2003. How effective do you think a refundable health insurance tax credit of $1,000 for individuals and $3,000 for families would be at reducing the ranks of the uninsured given rapidly rising health care costs?

Answer:

While we do not believe that all eligible taxpayers will take advantage of the health insurance tax credit proposed by the Administration, an extra $1,000 to $3,000 will make coverage more accessible to many lower and moderate-income Americans. The level of the credit and the income phaseouts were carefully designed so as to provide the maximum amount of benefit to those most in need, without causing a significant number of employers to drop coverage.

QFRs – Finance Hearing on FY2007 Budget

Rockefeller Question 3:

Mr. Secretary, I think the HCTC program is a good example of what happens when you use the tax code to try and expand health insurance coverage – people do not get the health coverage they need. Do you agree that, unless the law is changed to significantly increase the percentage of premium costs subsidized by HCTC, this program is likely to benefit only a small fraction of the vulnerable workers and their families who qualify for help?

Answer:

The HCTC program demonstrates that tax credits are a viable administrative and financing mechanism that can provide health coverage choice for eligible recipients. The issue of enrollment level is another matter that would undoubtedly exist regardless of the financing mechanism. The Trade Act affects two populations—displaced workers and certain early retirees—whose decisions about health insurance coverage are not well understood. They may have alternative coverage that is not eligible for the credit or they simply may conclude that they don't need coverage. We do not think it is necessarily true that the take-up level means that the tax credit is insufficient.

QFRs – Finance Hearing on FY2007 Budget

Rockefeller Question 4:

Mr. Secretary, here is a chart produced by DOL's OIG, showing all the steps required for advance payment to begin. As you can see, for TAA workers, 14 steps must be completed before advance payment of HCTC begins. For PBGC early retirees it's a little easier – only 9 steps are required. Mr. Secretary, don't you think we ought to be able to design a simpler process? What statutory changes, if any, are needed for HCTC advance payment to require just one application filed with a single agency?

Answer:

We are well aware of the complexity of the program and share your concern about the need to improve access. We have been thoroughly reviewing each step of the process to determine how to minimize time and complexity, and we are working with the Department of Labor to determine how we can better integrate our efforts. We want to make sure that all who want health coverage can obtain it as quickly and as simply as possible. We think these administrative efforts have improved the process and we believe ongoing efforts will further improve the system. Until the results of these efforts can be fully assessed, we do not believe legislative changes would be desirable and might prove to be counter-productive.

Rockefeller Question 5:

I noticed that the President's budget for Fiscal Year 2007 includes a provision that would allow states to impose a pre-existing condition restriction for a period of up to 12 months? Can you tell many how many HCTC eligible workers would lose coverage because of this proposal?

Answer:

There are no specific data on the amount of previous creditable coverage among the TAA and PBGC populations that might be eligible for the health coverage tax credit. However, considerable anecdotal experience suggests that most eligible people in these groups have much more than 12 months of coverage when they become eligible. This is because employers typically know well in advance of a shut-down that they have serious competitive or financial problems, and therefore, employers typically do not hire many new workers. Hence, when the closing occurs, the remaining employees have extensive tenure and health coverage.

We recommended the change because we believe it would facilitate more choices becoming available to potential users of HCTC. As we implemented the Trade Act, we found that the biggest concern among insurers was the criteria for state designated health plans to accept eligible enrollees with only three months of health coverage without any pre-existing condition restrictions. The standard, established by the Health Insurance Portability and Accountability Act (HIPAA) was 12 months. With the three month standard, insurers became concerned about increased adverse selection, and this requirement has been an obstacle to obtaining greater health plan participation in the HCTC program. We believe that the change to 12 months would affect very few individuals but would lead to greater participation by health plans in the program, which can lead to lower premiums and better options for eligible participants. And individuals with less than 12 months of previous coverage would still be eligible for the tax credit; they simply would have the same pre-existing condition restrictions that everyone else in the health system today faces.

Rockefeller Question 6:

This budget projects a deficit of $373 billion for the next fiscal year. But that is really only part of the story, because you still anticipate spending the Social Security surplus. So in reality, our debt is expected to increase by almost $700 billion next year.

On December 29th, you sent a letter to the leadership of this committee asking that Congress act quickly to increase the debt limit. In fact, the administration has asked that the current debt limit of $8.2 trillion be increased by almost $800 billion. That is the fourth debt limit increase requested by President Bush.

Can you tell me please, if Congress enacts an $800 billion increase in the federal debt limit, as I expect it will shortly, when will the administration request the next debt limit increase, and how much will it be?

Answer:

- The $373 billion deficit figure is our preferred measure since it represents our total borrowing requirements to borrow from the public. The $373 billion figure is the increase in debt held by the public.
- Cash surpluses generated by Social Security are deposited into the Trust Fund and invested in U. S. Treasury securities. All program revenues, including Trust Fund accumulations, will be spent on Social Security only.
- This process of crediting the Trust Fund with payroll taxes occurs regardless of whether the overall budget for the federal government is in surplus, in perfect balance, or in deficit.
- In other words, total federal debt would rise even with a zero unified deficit, due to the way we account for the funding of Social Security.
- In the longer term, the issue of the proper measures of the debt and deficit is secondary to getting a handle on entitlement spending itself. Until we develop sound, growth-enhancing solutions to avoid runaway entitlement spending, our longer term fiscal future is problematic, no matter how measured.

QFRs – Finance Hearing on FY2007 Budget

Rockefeller Question 7:

In light of the tremendous additional debt that the administration projects in this budget proposal, have you done any analysis of the impact of foreign borrowing? Under President Bush's stewardship, foreign debt holdings have doubled, from $1 trillion to $2 trillion. China alone holds more than $250 billion of our debt. Do you believe that depending on China to finance our government limits our diplomatic options when dealing with China?

Answer:

The market for Treasury securities is large, liquid, and deep. China could reduce its rate of accumulating Treasury securities, even substantially, without significantly affecting U.S. financial markets. Despite recent large purchases, China's holdings of Treasury securities are still modest relative to the size of the market. China's holdings of Treasury securities are estimated to be 7.8% of the $4.1 trillion in Treasury securities not held by U.S. Government and Federal Reserve accounts at the end of March.

Chinese investors bought around $98 billion in Treasury securities to their portfolios in the twelve months through March 2006. This is around $400 million per trading day. The daily turnover in the Treasury market is over $500 billion.

In this regard, it is notable that net purchases of U.S. securities by all foreign official institutions have declined substantially from the peak year 2004 without exerting a significant influence on U.S. financial markets. Foreign official purchases of long-term reached $236 billion in 2004, before falling to $111 billion in 2005.

Further, I would note that the U.S. is not alone among industrial countries in having a growing share of foreign holdings of its sovereign debt. Increasing foreign ownership of the Treasury market may also reflect a global trend of declining "home-country" bias and greater international diversification of portfolios.

The distribution of foreign holdings of U.S. public debt will not affect our diplomatic options when dealing with any country.

QFRs – Finance Hearing on FY2007 Budget

Rockefeller Question 8:

Mr. Secretary, the most pressing tax issue for most Americans is the individual Alternative Minimum Tax (AMT). Last year the President's budget was totally silent on the problem of the AMT. And you assured us at the time that the issue was being addressed by the President's Tax Reform Panel. That Panel submitted its recommendations to you more than three months ago. And yet, this year's budget does not address the long term challenges of the AMT. Instead, you have proposed just putting a band-aid on the problem – holding people harmless for one year. But while you deal with the AMT only for 2007, you propose that the dividend and capital gains tax cuts be extended beyond 2008. You offer no assurances to middle class families that they will not be hit with the AMT in 2008, but you want to rush to assure investors that they will not have a tax increase in 2009. Shouldn't it be a higher priority for Congress to fix the AMT, which will affect 20 million taxpayers as early as this year, than to address investor tax cuts that affect primarily wealthy taxpayers three years from now?

Answer:

Addressing the long-term AMT problem and making lower tax rates on capital gains and dividends permanent are both top priority items. The Administration is pleased with the AMT relief and the extension of the lower tax rates on dividends and capital gains contained in the Tax Increase Prevention and Reconciliation Act of 2005.

We have long recognized the problem of the AMT. The Administration believes, however, that because of the complexity of our tax system, the interrelationship between many of its provisions, and budgetary considerations, the long-term AMT problem should not be dealt with in isolation. Rather, solutions to the problems associated with the AMT over the longer term should be developed in the context of overall changes to the Federal tax system.

The lower tax rates on dividends and capital gains are an important part of the strong economic growth we have seen over the past several years. The weak business investment we saw just a few years ago has been replaced by 12 quarters of growth in business investment averaging over 9 percent. Permanent extension of the lower tax rates on dividends and capital gains is needed to avoid the adverse impacts on capital formation, investment, economic growth, and incomes in the future if these tax rates are allowed to rise.

Rockefeller Question 9:

I notice that once again the President has proposed tax free savings accounts that would allow an individual to save up to $5,000 in a retirement savings account and another $5,000 in a lifetime savings account. I do not believe that such a proposal addresses the real needs of people in my state. Not many West Virginians have an extra $10,000 per year to save. Indeed, our nation's personal savings rate was actually *negative* last year. Nationwide, only 4% of workers are saving the maximum amount in Individual Retirement Accounts (IRAs). It seems to me that if people cannot afford to put money into their IRAs, then providing a new way for them to save is of no benefit. Actually, I am concerned that creation of lifetime savings accounts would substantially hurt many workers. Under current law, small business owners receive a tax benefit for their own retirement savings if they provide a plan that covers some of their employees. However, lifetime savings accounts would eliminate this important incentive for employer-based retirement plans. Has the Treasury conducted any analysis on the impact of such accounts on small business participation in retirement plans?

Answer:

By creating one account dedicated to savings for any purpose, Lifetime Savings Accounts (LSAs) will simplify the rules related to tax-preferred savings. Making the rules easy to understand and reducing the need to sort through the maze of savings options will lead more individuals, especially those less financially sophisticated, to participate in tax-preferred savings.

LSAs are also tailored to the savings needs of low- and moderate-income taxpayers. As you point out, lower-income individuals have traditionally been less likely to participate in IRAs. With fewer resources to save, lower-income taxpayers may not want to contribute to an IRA because they might need to withdraw the funds – and pay an additional tax penalty on the withdrawals – in times of financial challenges. A survey shows that 56 percent of the families in the bottom quarter of the income distribution cite the need for liquidity or expected purchases as their primary reasons for saving, compared to 29 percent of the families in the top income quarter, whose primary reasons for saving are often education, home buying, or retirement – purposes that already qualify for savings incentives. Hence, by design, LSAs are targeted to lower-income taxpayers since they allow access to the funds for any purpose in times of need.

Since the introduction of the LSA proposal, we have listened carefully to the comments of various groups that are concerned with the effect of the proposal on retirement savings of employees in small businesses. The proposal has been designed to take into consideration these concerns, and we do not believe the proposed LSAs would eliminate the incentive for employers to provide retirement plans. Most employers – large and small – provide employees the opportunity to save in order to attract and retain a quality workforce, and this motivation will not go away with the enactment of the LSA proposal. Employees will continue to want employer plans, because such plans allow convenient saving through payroll deduction, often provide employer matching contributions, and have other advantages. Most importantly, employer-provided plans would have the advantage of offering pre-tax employee contributions.

In addition, the Administration included in the Budget a proposal that would consolidate all contributory defined contribution pension plans into Employment Retirement Savings Accounts (ERSAs) with simplified qualification requirements. ERSAs will reduce the administrative and compliance costs associated with offering a plan and simplify the decision of small employers as to what type of retirement plans to offer. We believe that simplifications in ERSAs will strengthen employer-provided retirement plans and therefore give access to savings incentives to many more taxpayers, especially employees of small businesses.

Rockefeller Question 10:

I have been impressed with the diversity of businesses and development projects financed with capital derived from the New Markets Tax Credit.

In my home state of West Virginia a small bank that was among the first CDEs to be awarded Credits has used their allocation to finance a number of small businesses in the state – in both urban and rural areas of the state. The Credit allowed the bank to provide flexible debt products that the businesses otherwise would not have been able to access – this allowing local businesses to grow and contribute to the employment base and the tax base of the community.

I am also aware of the Credit being used to finance a range of community facilities – including health care facilities, child care facilities and charter schools.

What else do we know about the types of businesses and projects being financed and the impact that these projects are having in communities?

I am also interested in learning more about the NMTC investor markets. I understand that NMTC investors include large regulated financial institutions as well as some of the larger unregulated financial companies.

The intent of the NMTC is to bring investors into 'new markets' to demonstrate that there are viable business opportunities in these markets and strong and experienced CDEs to partner with.

What can you tell me about the institutions that are investing in CDEs in exchange for the New Markets Tax Credit?

Answer:

Investors have been very quick to embrace the NMTC Program. As of February 15, 2005, investors have invested $4.1 billion of equity into qualified Community Development Entities (CDEs); or over one-half of the $8 billion in total authority that the CDFI Fund has allocated to CDEs to date. This is a remarkable pace, given the relative early stage of the program and the fact that CDEs are permitted by statute up to five years to raise investor capital.

Based on data from December 1, 2005, 93% of NMTC tax credit claimants are corporations, and 7% are individuals. Of the corporate tax credit claimants, the largest single class of investors is banks or other regulated financial institutions. They comprise approximately 44% of all corporate claimants. Other classes of corporate investors include investment banks (11% of corporate claimants) and insurance companies (3% of corporate claimants).

Approximately 59% of the investor dollars have been provided by entities that are not affiliated with the CDE; and approximately 57% of the investment dollars were provided by organizations that had not previously invested in the CDE.

Rockefeller Question 12:

I have been very pleased with the success of the QZAB program in West Virginia. The program has encouraged innovative partnerships between rural and needy schools and local communities to help invest in improving school buildings which expand learning opportunities for students. Studies indicate that quality learning environments enhance education. I am pleased to see that the Administration supports continuation of the program without major changes that could hinder local partnerships or reduce the long-term value of the bonds. What kind of school improvements have been realized as a result of QZABs? I notice that the budget calls for additional reporting in the program, what information about local partnerships would be more helpful in managing this program, and helping more communities take advantage of the QZAB program?

Answer:

State and local governments may issue QZABs to finance school repairs, equipment, course materials, and teacher training (but not new construction). Without required reporting of QZAB deals, systematic information on what types of projects the tax credit bonds have been used to finance does not exist. There is anecdotal evidence that many bonds are used for school repairs.

The budget would require QZAB issuers to file Form 8038G, currently filed by issuers of public-purpose tax-exempt bonds. Because school districts benefiting from QZAB issuance require written commitments from private entities to make qualified contributions of property or services with a present value equal to at least 10 percent of the proceeds of the QZAB, the identity and contribution of the private sector partner could also be disclosed on a separate attachment.

Such disclosure would facilitate evaluation of the effectiveness of the QZABs program and assist in its administration by the IRS.

QFRs – Finance Hearing on FY2007 Budget

Bingaman Question 1:

Could you please provide us with all data you have compiled on the number of purchasers of HSAs in regards to the level of funding of these accounts. As much as possible, please break this data out by income groups.

Answer:

Enrollment in HSA-qualified HDHPs has grown to nearly 3.2 million individuals in January 2006, according to the latest estimates from America's Health Insurance Plans (AHIP). According to AHIP estimates, roughly one-third of those who purchased HSA-eligible HDHPs in the non-group market were previously uninsured. In addition, over 40 percent of those purchasing HDHPs through eHealthInsurance have incomes below $50,000 and about 50 percent are age 40 or over.

QFRs – Finance Hearing on FY2007 Budget

Bingaman Question 2:

Could you please provide us with all the data and research you have compiled on the cost of HSA-eligible health insurance policies as it relates to the coverage provided and how this compares to more traditional employer-provided health insurance policies?

Answer:

High deductible health insurance tends to cost less than first-dollar and low-deductible health insurance because it does not pay for the more routine costs. To the extent health insurance covers costs that nearly everyone incurs, the less it constitutes insurance – that is, the less it constitutes risk shifting.

The concept of "traditional employer-provided health insurance" has been consistently changing. We do not have data comparing coverage in typical HSA-eligible coverage with that of traditional employer-provided health insurance. However, it is clearly documented by others (e.g., the Kaiser Family Foundation's annual Employer Health Benefits Survey) that the average level of deductible for employer-provided coverage has been increasing over the recent past.

QFRs -- Finance Hearing on FY2007 Budget

Senator Bingaman Question 3:

It is my understanding that the Mexican Government is advocating the closing of the North American Development Bank (NADB), an integral piece of the NAFTA negotiations, due to various policies and procedures that have inhibited lending and a lack of collaboration between U.S. and Mexican officials. What is the U.S. Government's position on closing NADB, and what is your justification for this position? Why has the USG failed to implement reforms to improve the lending capability of the Bank, even after a $1 million business process review was conducted? Is the USG backing away from its NAFTA promise to provide funds to address border environmental issues?

Answer

- There are no plans to close the Bank, but both the U.S. government and the Mexican government have serious concerns about the Bank.
- The Bank has not been performing as effectively as intended, and taxpayers' dollars are not being used as effectively as they should be. For example, the Bank has spent $2.50 in administrative costs for every $1 of lending for projects in the U.S.
- The Administration remains committed to programs for environmental infrastructure in the border region.

QFRs – Finance Hearing on FY2007 Budget

From Senator Kerry:

Kerry Question 1:

Secretary Snow, the Administration's budget for fiscal year 2007 does not adequately address the individual alternative minimum tax (AMT), but it does make the 2001 and 2003 tax cuts permanent. Can you explain the interaction between the tax cuts and the AMT? If the AMT is not addressed won't it "take back" a percentage of the tax cuts? According to the Urban Institute-Brookings Tax Policy Center, by 2010 the AMT will take back about 29 percent of the overall income tax cut, including more than 71 percent of the cut targeted to taxpayers with income between $200,000 and $500,000. Do you agree with this statistic? By choosing to inadequately address AMT in 2006 and only address the AMT for 2006 aren't the true costs of the tax cuts being masked? What would the five-year and 10-year costs of making the tax cuts permanent be if the AMT exemption amount was increased to the level in the Senate Finance tax reconciliation bill and indexed for inflation?

Answer:

The AMT can reduce the benefits of the 2001 and 2003 tax cuts for some taxpayers. The Administration has long recognized the problem of the AMT. We strongly believe that solutions to the long-term AMT problem should be resolved in the context of overall changes to the entire Federal tax system.

Because the Urban Institute-Brookings Tax Policy Center report you cite was not produced by the Treasury Department, we are not in a position to verify its accuracy.

The Administration is pleased with the enactment of the AMT relief contained in the Tax Increase Prevention and Reconciliation Act of 2005. The longer term solution to the AMT issue lies in reforming the entire Federal tax system.

Kerry Question 2:

Yesterday, the IRS issued a press release that addresses the steps that are being taken by the IRS to address questions raised about the Questionable Refund Program (QRP). I am glad that some progress has been made on this issue, but there are still unanswered questions. The IRS release mentions that taxpayers will receive notice that their refunds are being frozen. How long will it take to implement this process and notify all the taxpayers that have had their refunds frozen? How will the improved filtering system work? What will be the new expedited process for releasing refunds that were erroneously frozen?

Answer:

This filing season the IRS is implementing new procedures, in partnership with the Taxpayer Advocate, to immediately notify taxpayers that it is freezing their refunds. The IRS will also automatically release refunds after an established timeline if it has not determined a particular return requires additional verification, and will minimize automatic freezes on taxpayers' accounts in future years.

In addition, the IRS will refine our identification and selection criteria and review refunds frozen from 2004 and prior tax years. Determining the proper disposition of these cases will require additional time and resources. The IRS will either process the refund or notify the taxpayer to give the taxpayer an opportunity to substantiate the claim. Notices will be mailed to taxpayers and will be written in both English and Spanish. The IRS plans to have these completed this year.

To improve the refund filtering system, the IRS has contracted with the Department of Health and Human Services (HHS) to verify wages for taxpayers who claim the EITC. This HHS database, which gives the IRS access to salary data updated quarterly, was not available until this year. This filter will help the IRS release legitimate refunds with an EITC component faster because it automatically verifies the wages and withholding credits. This will greatly reduce the number of initial freezes on questionable refund requests that have an EITC component because we will not need to contact employers to verify income. It will give the IRS more time to focus on scheme identification. The IRS continually examines and updates all of the filters used to screen refund requests, and as systems become more refined, the IRS's ability to detect fraud will increase while the effect on legitimate taxpayers will decrease. To this end, the Treasury Inspector General for Tax Administration (TIGTA) is currently conducting an audit of the filtering system to assess its effectiveness and identify potential improvements.

QFRs – Finance Hearing on FY2007 Budget

Kerry Question 3:

On January 19, 2006, I along with Senator Obama sent a letter to Commissioner Everson requesting information about the QRP and a requested a response by February 1, 2006. I have not yet received a response. Why is the IRS more focused on low income taxpayers that benefit from the earned income tax credit than on those who do not file or underreport their income?

Answer:

The QRP does not focus on individual taxpayers or groups of taxpayers. It identifies patterns using various investigative tools and filters. Once the IRS identifies a scheme pattern, it applies that information to each refund return in that pattern to determine its legitimacy.

While the portion of the tax gap attributable to EITC error is less than 4 percent, it has been consistently listed among high-risk federal programs. In the Balanced Budget Act of 1997, the Congress recognized this by enacting legislation for a separate 5-year appropriation, averaging $143,000,000 a year, to address EITC compliance beginning in FY 1998 and ending in FY 2002. The IRS has used these resources to conduct audits and investigations of these claims with positive results. In the first year of the appropriation, the IRS conducted over 350,000 examinations with recommended assessments of over a half a billion dollars.

The IRS's ability to identify and prosecute those who commit refund fraud has improved. The focus of the IRS's criminal investigations has never been on legitimate individual EITC recipients but on combating criminals and criminal activity.

QFRs – Finance Hearing on FY2007 Budget

Kerry Question 4:

I believe that it is important that researchers have access to timely information about audits, in order to determine the fairness of the process. Why has the IRS chosen to no longer release this information?

Answer:

In 2004, the Transactional Research Access Clearinghouse (TRAC) significantly increased the specificity and frequency of its information requests. As a result of the IRS's reorganization, much of the requested information previously available to TRAC on a geographic basis was no longer readily available. Therefore, the IRS was unable to provide TRAC with the same information provided in prior years. Because this matter is currently pending in litigation, any further comment would not be appropriate.

Kerry Question 5:

The President mentioned in his State of the Union address that he is going to create a commission on Social Security, Medicare, and Medicaid. The budget released yesterday includes a plan to create voluntary personal retirement accounts. I am concerned that the inclusion of this proposal indicates that the Administration is still advocating private accounts and that once again a commission would be skewed with members who support this concept. What will be the structure of such a commission? Will it be created by Executive Order? What assurances will there be that such a commission has no preconceived outcomes? For example, President's Advisory Panel on Federal Tax Reform was given a specific baseline to use and this limited the outcome of the panel's report.

Answer:

- There's no question that the biggest challenge to our nation's fiscal health remains the growth of entitlement spending, including Social Security and Medicare.

- Republicans and Democrats need to come together and work together to modernize Social Security and Medicare so they remain viable for our children and grandchildren. As the President has recently noted, Congress must set aside needless partisan politics and focus on the future of our country with real, substantive entitlement reform.

- As for the status of the commission, we understand that plans are still underway to craft the commission in a serious, bipartisan fashion. There are ongoing conversations with Members of Congress from both chambers and from both sides of the aisle.

- The fact is that if we want to address these issues in the manner they deserve - putting together the commission requires thoughtful and careful planning. Republicans and Democrats alike understand that the entitlement challenge can only be solved through a bipartisan approach.

QFRs – Finance Hearing on FY2007 Budget

From Senator Lincoln:

Lincoln Question 1:

How many currently uninsured Americans will be covered with your Health Savings Account proposal? I know the White House has said your proposal would raise the projected number of HSA participants in 2010 from 14 million to 21 million, but how many of these people will be newly insured and how many will be simply shifting from another form of insurance?

Answer:

There are two mechanisms through which the administration's health care proposals will encourage the uninsured to purchase health insurance. First, the HSA expansions will lead to a greater number of High Deductible Health Plans (HDHPs). Indeed, the Treasury Department estimates that these proposals would increase the number of HSAs by 50 percent, from 14 million to 21 million. HDHPs provide consumers with a much larger role in health care by requiring that the consumer bear a larger share of the financial responsibility for his or her health care decisions, thus bringing market forces to bear on the cost of medical expenditures.

In health care markets where market forces are prevalent, health care costs have grown slower or, in some cases, even decreased. Increased market forces resulting from the President's initiative will help reduce the rate of growth in national health expenditures. This reduces the cost of health care and encourages the purchase of health insurance.

Moreover, the structure of the subsidy includes a refundable income tax credit that would, through the income tax system, refund the payroll taxes paid on the portion of wages spent on health care. This provides a significant incentive to low income individuals to purchase health insurance. Second, the Health Insurance Tax Credit (HITC) provides a significant subsidy to low income individuals for the purchase of HDHPs.

QFRs – Finance Hearing on FY2007 Budget

Lincoln Question 2:

In a recent paper from the National Bureau of Economic Research (NBER), Prof. Jonathan Gruber of MIT and NBER found that "expanding public insurance is a more efficient option than any tax policy considered so far" if it is the objective of the federal government to reduce the number of uninsured Americans.

Would you agree that using tax policy to address the problems of the uninsured is a less than efficient economic option? If so, from an economic standpoint, would the federal government be better by off simply expanding existing public insurance programs rather than using tax policy?

Answer:

We believe that most Americans value the opportunity to choose an insurance product with characteristics they care about, including size and composition of provider network, benefits covered, degree and composition of cost-sharing obligations, and the degree to which their health care is managed. When the government provides the insurance, the ability to make these choices is sharply curtailed. That is why we favor making privately marketed insurance more affordable through tax credits as opposed to expansions of public programs.

Lincoln Question 3:

How do you reconcile HSAs with the need for tax simplification? In your view, don't HSAs contribute to the tax confusion that tax reform will purportedly alleviate?

Answer:

While we have not made specific tax simplification recommendations, HSA expansions do address one important distortion in the tax code, which is the excessive preference for health insurance relative to out-of-pocket health care costs. The expected benefit—slowing the growth of low value health care spending—is a very important policy goal.

Lincoln Question 4:

One of the largest revenue offsets in the President's budget would raise $3.3 billion from low-income working families by 'simplifying' the refundable child tax credit.

Can you explain why the Administration targeted this provision for a tax increase? Can you explain to me in detail exactly how this revenue is being raised? Shouldn't the revenue raised be returned to these low-income families through sensible expansion of the credit?

Answer:

- Under the proposal, the additional child tax credit would define earned income in the same way as it is defined for the EITC and other tax provisions. In addition, both credits would have the same U.S. residency requirements. The proposal would reduce confusion for nine million taxpayers who claim both the additional child tax credit and the EITC.
- The proposal would simplify computations for over two million families with three or more children.
- The proposal would eliminate six lines from the tax schedule used to claim the additional child credit and two worksheets.

Lincoln Question 5:

As I have mentioned to you at two recent hearings, the refundable child tax credit in its current form is inequitable. A single parent that works full-time, every week of the year, at minimum wage doesn't earn enough to even meet the income threshold for the refundable child tax credit. And because the income threshold is indexed for inflation, more and more low-income working parents are shut out of receiving the much-needed benefits of this credit each year.

Is there any policy reason to support the status quo here? Is it the position of this Administration that low-income workers are less deserving of the credit's benefit?

If not, will you work with Senator Snowe and I to fix this problem? For your review, I've attached legislative language we have recently introduced that would de-index the income threshold and set it at $10,000. I would appreciate your feedback and cooperation in working to address this inequity.

Answer:

The child tax credit provides needed assistance to families with children. The partially refundable portion of the credit allows this amount to be provided through the tax system even to many taxpayers who do not owe income tax. To be eligible for the refundable portion of the credit, however, taxpayers must work. A similar requirement applies to the refundable earned income tax credit (EITC).

In addition to the common work requirement, the refundable portion of the child tax credit was designed in other ways to complement the EITC. As you point out, Congress established an indexed $10,000 minimum earned income requirement when it expanded the refundable portion of the child tax credit in 2001. This minimum earned income threshold generally corresponds to the end of the phase-in range for the earned income tax credit (EITC) for families with two or more children. As a consequence, the refundable portion of the child tax credit first effectively continues to reward work for low-income families with incomes beyond the end of the EITC phase-in range. Then, at somewhat higher income levels, the refundable child tax credit reduces the marginal tax rates for families subject to the EITC phase-out rates.

As you know, the EITC thresholds are indexed for changes in the cost of living, thus protecting recipients' benefits from being eroded by inflation. To maintain coordination between the two credits, the minimum earned income threshold for the refundable child tax credit is also indexed for inflation.

The Administration has a proposal to reduce the computational complexity of the refundable portion of the child tax credit. This proposal would simplify the credit by eliminating multiple computations, conforming the definition of earned income to that set forth elsewhere in the tax code, and requiring U.S. residence. We look forward to working with you on simplification and reform of the child tax credit to ensure that it provides the benefit intended by Congress.

Lincoln Question 6:

The Administration continues to push for estate tax repeal, and even includes repeal in this budget. As I'm sure you are aware, there are many that believe, due to current budgetary constraints, a more likely scenario is one in which the estate tax is reformed, through either lower rates, higher exemptions, or some combination of the two.

Will the Administration be supportive of estate tax reform in lieu of real opportunities for estate tax repeal?

What do you see as the bigger, or more important, piece to the estate tax reform puzzle– lower rates or higher exemptions?

Answer:

- Eliminating the death tax is a matter of basic fairness. The death tax results in the double taxation of many family assets while hurting the source of most new jobs in this country -- America's small businesses. Permanent repeal of the death tax would relieve thousands of families with small businesses, farms, and ranches of its excessive and unfair costs and would mean that many more family businesses could thrive as a source of continuing job creation and economic growth. The death tax is much more than just a tax on the wealth of individuals at the time of death. Fundamentally, the death tax penalizes savings and risk-taking, reduces capital formation in the economy, and, ultimately, reduces living standards. Unfortunately, the provision of the 2001 Act that repeals the death tax expires at the end of 2010, creating significant uncertainty for family estate planning.

- The time to fix this problem is now, so American families can plan for the future without worrying about whether the death tax will reemerge. Making the repeal permanent will ensure that Americans can save for their children's education, undertake new business ventures, budget for charitable contributions, and plan for retirement and the transfer of family businesses, farms, and ranches with the knowledge that Congress has acted to eliminate uncertainty.

- The Administration urges quick action in Congress to make the elimination of the death tax permanent.

QFRs – Finance Hearing on FY2007 Budget

Schumer Question 1:

I know you are here to discuss the budget, but a trip to the Finance Committee just wouldn't be complete without a couple of questions about China.

Secretary Snow, as you know, we have been having this conversation about the problems with China's currency for some time now. Soon after Treasury released the currency report in May of 2005, you testified before the Banking Committee. At that hearing, I asked you what happens if nothing changes six months from now, what happens if China fails to move?

You told me at the time that what concerned you most was their lack of progress, given China's growing ability to reform itself, and you told me that if this trend were to continue, they could be termed as currency manipulators in the report due last October, which was actually released after the President's trip in November. This report also failed to take the step that we were all waiting for.

Since the release of the most recent report, you have made several public statements indicating your displeasure with China's lack of movement. I am also displeased. With all due respect, Mr. Secretary, the Bush Administration's case that China is not a currency manipulator is no longer convincing or plausible. It doesn't take a rocket scientist to figure out that when a country says it will let market forces work, and then the currency fails to move despite 10 percent economic growth, that country is manipulating, plain and simple.

The simple fact is that the Administration ought to be able to say: "China is manipulating its currency, which harms the U.S. economy, particularly in manufacturing, and we're committed to doing something about it." Why can't the Bush Administration bring itself to say these words?

Answer:

China's international economic and exchange rate policies are deeply concerning. The United States has been joined by the international community, including the G-7, the IMF, and Asian Development Bank, in vigorously encouraging China to implement greater exchange rate flexibility. In the final analysis, though, the Treasury Department was unable to conclude that China's intent has been to manage its exchange rate regime for the purposes of preventing effective balance of payments adjustment or gaining unfair competitive advantage in international trade. The Chinese leadership has publicly committed to rebalancing growth to place more emphasis on domestic demand; to increasing their imports; and to reducing their current account surplus. Thus, we have not designated China pursuant to the 1988 Trade Act.

QFRs – Finance Hearing on FY2007 Budget

Schumer Question 2:

At the same Banking Committee hearing, in response to one of Senator Bayh's questions, you stated that if China was to avoid being termed a manipulator in your next report, China's move would have to be, again I quote, "materially significant, and [it would have] to change the adjustment process in a real way." Yet the most recent currency report again fell short.

I take that to mean that the Bush Administration, despite its public clams that the currency is the most important economic issue with respect to China, believes that 2.5 percent is enough, and, in your own words, their July move "changed the adjustment process in a real way"? If not, why should we take you at your word? What's it going to take to get the Administration to stand up in a real way for America's workers and manufacturers? Senator Graham and I have been promised a vote on our bill by March 31 – why should we continue to be patient?

Answer:

As you noted during your recent trip to China, the Chinese leadership is publicly committed to change of its currency regime. They have adopted a new Five-Year Plan and their leadership including President Hu, Premier Wen, Finance Minister Jin, and People's Bank of China Governor Zhou have publicly committed to measures to increase currency flexibility, increase imports, and rebalance growth to rely more on domestic demand.

<u>Schumer Question 3:</u>

On a similar point, Mr. Secretary, I know you were hoping that China would revalue its currency again around the time of the President's visit in November, but they did nothing. What did we actually get out of the President's visit there, and what do we hope to get when President Hu comes here in April?

<u>Answer:</u>

This Administration's intensive engagement at all levels, including by President Bush, has resulted in the adoption of real policy changes by the Chinese government. During his trip to the United States, President Hu announced that China would "continue to advance the reform of the RMB exchange rate regime, and take positive steps in such areas as expanding market access, increasing imports, and strengthening the protection of intellectual property rights." We will closely monitor and engage the Chinese government to ensure that they live up to these commitments.

Additional QFRs for FY2007 Budget Hearing
Raised by Senator Rockefeller
June 27, 2006

Additional question raised from Rockefeller Question 1:

In the response to question #1, you cite a 50 percent increase between "200X" and "200X". Could you please give us the actual years for which this increase is expected, and please let us know what study you are citing?

Additional Response

The dates in both instances should have read "2010." These estimates are based on Treasury Department analysis.

Additional question raised from Rockefeller Question 2:

Senator Rockefeller asked how effective the refundable health insurance tax credit would be at reducing the ranks of uninsured. The answer does not give any estimate on how many people would actually use the credit. How many people does Treasury estimate would actually use such a credit?

Additional Response

The President's health care initiative is intended to address the rising cost of health care in several ways. First, the initiative gives individuals a greater stake in their health care decisions by emphasizing high deductible health insurance. A fundamental principle underlying the initiative is that when individuals are more involved in their health care decisions, those decisions will be better ones. Putting the health care consumer more in control of health care decisions, rather than third parties, such as insurance companies, employers, and the government, will help reduce the rise in health care costs.

Second, the initiative fundamentally alters the tax incentives that underlie the current health care system by providing the same tax subsidy available to health insurance purchased through employers to health care purchased directly by individuals. Through a series of tax provisions, the ability of individuals to pay for health insurance through an employer without paying either income or payroll taxes is extended to individuals who purchase health care directly, provided they have a high deductible health plan. These provisions have the effect of removing the tax bias or leveling the playing field between insurance purchased through employers and high deductible insurance purchased directly by individuals. Similarly, the initiative also levels the playing field between health insurance and out-of-pocket health care purchases for those with high deductible health plans.

While this proposal both puts health care consumers more in control over their health care decisions and addresses important tax biases that underlie our current health care system, the initiative only increases the existing subsidy for health care (which arises primarily from the subsidy for employer-sponsored insurance) from about $325 billion to $345 billion in 2010 (Treasury Department estimates).

It is important to consider this initiative as a package, because the individual provisions work in unison to address the inequity and the uneven treatment of health care in our current system. The Treasury Department estimates that these proposals will have a dramatic effect on the number of HSAs, increasing their number in 2010 by 50 percent. Under current law, the Treasury Department estimates that there will be about 14 million HSAs in 2010. Under the President's initiative, the number of HSAs is estimated to rise to about 21 million in 2010. That is, some 21 million taxpayers would directly benefit under the President's health care initiative. Of course, helping to lower the growth in health care costs is a central objective of the initiative and the anticipated rise in the number of HSAs is important to achieving this objective.

As you indicate in your question, the Administration has included in this initiative a proposal for a refundable health insurance tax credit targeted to lower income Americans. This credit would cover up to 90 percent of insurance premiums and would be up to $1,000 for singles and up to $3,000 for families.

Importantly, the estimated effects of this credit include the interaction with other elements of the President's health care initiative, such as the deduction for high deductible health insurance premiums and the tax credit for payroll taxes paid on such insurance premiums. It is difficult to isolate accurately the effect of a specific provision included in the initiative because of the very significant interactions between the various provisions included in the initiative. For example, the number of taxpayers who benefit from the targeted refundable health insurance tax credit depends on whether the estimates reflect the effect of the deduction for high deductible health plans and the refundable tax credit for payroll taxes paid on such insurance premiums. Accordingly, we do not have a precise estimate at this time of how many people would use the credit. Regardless of the effect of the specific provision, the overall initiative would benefit all of the taxpayers, who are estimate to hold the 21 million HSAs in 2010, referred to above.

We would be pleased to discuss these issues with your staff, including the various interactions between the specific provisions included in the initiative.

Additional question raised from Rockefeller Question 4:

Treasury indicates that legislative changes would not be desirable until the results of administrative efforts can be fully assessed. When will the results be "fully assessed"?

Additional Response

During the past year, the IRS has taken steps to reduce the administrative costs of the program and to make enrollment simpler. The IRS is in the process of making considerable improvements, which we expect to be in place by September 30, 2006. However, it is likely that further improvements might require consideration of the underlying non-tax rules related to eligibility.

Additional question raised from Rockefeller Question 6:

Even recognizing that Treasury cannot predict with certainty when the administration will next request a debt limit increase, the answer to question #6 is simply not responsive. Certainly Treasury has projections about future borrowing rates. Based on available projections, when will the debt limit next need to be increased?

Additional Response

Current estimates suggest that the debt limit most likely will be reached at some point in the second half of calendar year 2007. However, deficit projections are always quite uncertain. In some scenarios, the debt limit might not be reached until calendar year 2008.

NEWS RELEASE
OLYMPIA SNOWE
U.S. Senator for Maine

FOR IMMEDIATE RELEASE
Tuesday, February 07, 2006
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SNOWE STATEMENT AT FINANCE COMMITTEE HEARING ON BUSH ADMINISTRATION'S TAX PORTION OF THE BUDGET

WASHINGTON, D.C. – A member of the Senate Finance Committee, U.S. Senator Olympia J. Snowe (R-Maine) issued the following statement today at a hearing on the tax portion of the Bush Administration's Fiscal Year (FY) 2007 Budget with Treasury Secretary John Snow:

We come here today, Mr. Chairman, at a time in which the American economy appears to be on a solid footing. The Commerce Department reported on January 27 that the economy grew 3.5 percent in 2005. This year, the Congressional Budget Office forecasts that the economy will expand 3.6 percent. Not only is the economy growing, but it is also adding jobs. On February 3, the Labor Department reported that the economy added 193,000 new jobs in January. Moreover, the January unemployment rate fell from 4.9 percent to 4.7 percent, a historically low level and the lowest since July of 2001.

Despite these reasons for optimism, there also exist reasons to be concerned. Specifically, Mr. Chairman, we are facing a federal budget deficit that is unmatched in this Nation's history. And given projections of economic growth, the red ink appears structural rather than cyclical. According to the Congressional Budget Office, the federal deficit for 2006 is expected to be at least $337 billion and more likely $360 billion. Moreover, the deficit for the next ten years is expected to be well over $800 billion, and that's only if we enact no new spending, and the tax cuts passed in 2001 and 2003 are allowed to expire, clearly unrealistic assumptions.

If we renew all of these expiring tax cuts and other popular tax breaks, such as the research and experimentation tax credit, as well as mitigate the impact of the increasingly onerous alternative minimum tax, our Nation could face $4.2 trillion in red ink over the next 10 years. Clearly, in order for this Nation to reach its full economic potential, it is imperative that we understand the harmful effects that the deficit will have on us and on our future.

In considering these issues, though, we need to be fair in terms of recognizing how we arrived at this position. On September 11th of 2001, our Nation was the victim of a horrific terrorist attack that pushed an already fragile economy into a recession. Then, our country became engaged in military operations in Iraq that led to an increased amount of spending in our military and in our Nation's Homeland Security Department. Finally, last fall, three hurricanes ravaged the Gulf Coast, necessitating a significant commitment of Federal resources to rebuild the area. Make no mistake that these expenditures were absolutely essential for our national security and the economic well-being of our citizens and received near unanimous support.

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Nevertheless, the projected deficits are real, and it is something that we must address. Indeed, therein lies the question Mr. Chairman - are we going to follow a sound fiscal policy in terms of our Nation's spending and tax policies or are we simply going to pass our debts on to our children and in the process jeopardize our long-term economic prospects?

In making this choice, we are certainly going to be forced to make some extremely difficult decisions - decisions that require us to address options that either increase our Nation's revenues or decrease our Nation's spending. In short, we needed to address America's priorities in a fiscally responsible manner.

For it is this commitment to fiscal responsibility that brings me here today - with serious concerns about the President's budget for fiscal year 2007. Specifically, I am here to express my concerns regarding the President's proposal for Congress to enact legislation that would make permanent each of the tax cuts passed in 2001 and 2003 that are set to expire while, at the same time, proposing deep cuts in spending.

While I am truly sympathetic to the demanding tax burden that confronts many American citizens, particularly those who own small businesses or those who might face the alternative minimum tax, I remain just as concerned about whether we can afford to continue on this path.

For example, according to estimates provided by the Congressional Budget Office and the Joint Committee on Taxation, federal revenues would decrease by approximately $2 trillion over the next ten years if the tax cuts enacted in 2001 and 2003, as well as other routinely extended expiring tax incentives, were made permanent. In addition, it is estimated that the higher interest payments on the increasing national debt would add approximately $324 billion to this total, meaning the total cost over the next ten years would be over $2.3 trillion.

And those figures do not include a patch for the individual alternative minimum tax, which is forecast to affect 4 million taxpayers in 2005 and 20 million in 2006. If Congress enacted an AMT patch and passed all the tax cuts listed above, the total federal deficit, including debt service costs, would total over $4.2 trillion over the next 10 years.

The point is that absent sound assurance that fiscal revenues will grow at a similar pace, I simply cannot see how extending all of these tax cuts is warranted if we are operating under a policy of fiscal responsibility. This is not to suggest, however, that I am opposed to addressing the issue in its entirety or that I am against tax cuts. Indeed, Mr. Chairman, as I have said over the last several months, we must end the "fiscal shell game" where we extend tax cuts for only a year or two at a time in order to mask their true long-term costs. We should take a hard look at the tax laws and make permanent the most meritorious tax cuts. Moreover, as I expressed earlier, I appreciate the substantial tax burden that the alternative minimum tax places on many taxpayers. I look forward to working with both you and the Administration in identifying opportunities where we can reduce this burden in a fiscally responsible manner.

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Committee on Finance

The President's Fiscal Year 2007 Budget Proposal

Statement for the Record from Senator Thomas

February 7, 2006

I commend the Administration for continuing to advance the goal of cutting the deficit in half by 2009.

I continue to be concerned about government spending, and I agree that we need to hold federal programs to a firm test of accountability. 1965 was the last time Congress actually cut spending from one year to the next. Government spending has continually grown for the last 40 years.

However, I am encouraged by the current focus on cutting spending and encouraging growth. Our current economic path – with the exception of unusual spending necessitated by Katrina and Rita – has generally worked well, resulting in annual growth of 3.6% over 2005, reducing unemployment to 4.9%, and dramatically increasing household wealth – up 28% since 2001.

I particularly agree with the Administration's commitment to increased personal financial responsibility and flexibility.

This commitment is reflected in the budget proposals to simplify and encourage savings. Our nation's savings rate has hit a new historic all-time low of less than 0%, and at the same time consumer debt is skyrocketing.

Add to these statistics the increasing strain on Social Security and our health care and pension systems, and it's clear we need to make some tough choices now.

Last year I introduced the Savings Account Vehicle Enhancement (SAVE) package, including the lifetime savings account (LSA), the retirement savings account (RSA), and the employer-provided retirement savings account (ERSA). I'm pleased to see that the Administration continues to support these initiatives.

I am also pleased that this budget proposes to significantly strengthen health savings accounts (HSAs). These accounts are similarly important to the whole notion of personal financial freedom and flexibility.

I look forward to working with the Administration to move these important initiatives forward.