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**CBO'S OPTIONS FOR RAISING REVENUES AND
CHANCES IN TAX LAW, 1980 TO 1993**

**A Review by the Tax Analysis Division
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A review of CBO's options for raising revenues since 1980 reveals that:

- o Many have since been enacted into law, substantially, if not entirely.
- o Tax preferences that were sacred cows in 1980, such as mortgage interest deductions and deferral of capital gains taxes on home sales, seem no less inviolate today.

Early on, CBO staff determined that options for raising revenues should stress certain major themes, discussing the arguments for and against and providing readers with estimates that would be updated each year of revenue increases resulting from:

- o Raising marginal tax rates;
- o Broadening the tax base by removing preferences entirely (to suggest scale) and by enacting more modest cutbacks (to inject a measure of realism);
- o Increasing excise taxes (on specified services or products, such as alcohol and tobacco);
- o Imposing broad-based energy taxes; and
- o Levying a broad-based consumption tax.

Thus, the broad themes of current options, and even some specific options for reducing or eliminating tax preferences, are virtually unchanged since the early 1980s. Since the passage of the Tax Reform Act of 1986 (TRA-86), however, options for raising tax rates have received relatively more emphasis than they had previously. Overall, the options have stressed that a broad-

based consumption tax, such as a VAT, could raise large sums less easily than incremental increases in income tax rates, but with less loss of economic efficiency; that excise taxes on selected products could be raised to minor good effect; and that broadening the tax base could raise significant sums and improve economic efficiency.

CBO published its first budget reduction options in 1980. At the time, tax rates were high—the top marginal rate was 70 percent—and thus the focus of CBO's options was on raising revenues by reducing tax preferences. The Economic Recovery Tax Act of 1981 (ERTA-81) reflected a different strategy: it lowered tax rates and enacted new tax preferences. A year later, CBO discussed in general terms a fundamental restructuring of the tax system, pointing out that a broad-based income tax with fewer deductions, exclusions and exemptions would make possible lower rates. CBO noted that with sufficient base-broadening, "a top marginal rate of less than 30 percent" for individuals could raise "the same amount [of revenue] as the present system." The Tax Reform Act of 1986 reduced the top marginal tax rate for individuals to 28 percent and broadened the base by cutting back on tax preferences.

Over the years, some of the options that CBO has put forth have become law; others are still current, although their form may have changed. Following is a listing of major items, broken down by whether or not (and, if so, to what extent) the Congress has enacted the option into law. An asterisk next to an item indicates that the option is in some form still current, which may be the case even if the Congress has taken substantial measures toward enacting it. Some options, such as raising marginal tax rates, are presented each year, to provide estimates of revenue effects for informational purposes. Thus, if the Congress has enacted rate increases in any year, CBO will present an option for still higher rates. Options for broadening the tax base will generally remain until the preference has been eliminated entirely.

The Congress has substantially, if not entirely enacted the following options.

- o Raise marginal tax rates for individuals and corporations*
- o Raise the alternative minimum tax for individuals and corporations*
- o Increase taxation of Social Security and Railroad Retirement benefits*
- o Broaden the Medicare tax base*
- o Decrease limits on contributions to qualified pension and profit-sharing plans*
- o Mark securities dealers' inventories to market value
- o Restrict deductions for business meals and entertainment
- o Increase aviation-related excise taxes
- o Increase and extend the telephone excise tax

- o Eliminate income averaging
- o Eliminate the charitable deduction for nonitemizers
- o Eliminate the deduction for state and local sales taxes
- o Combine miscellaneous deductions and employee business expense deductions and subject them to a floor based on a percentage of AGI
- o Limit deductions for medical expenses
- o Repeal the dividend exclusion
- o Repeal the tax credit for employee stock ownership plans
- o Tax unemployment compensation
- o Repeal the exclusion of net interest
- o Revise depreciation rules
- o Repeal the investment tax credit
- o Restrict use of the cash method of accounting
- o Extend the at-risk limitation
- o Restrict tax-motivated leasing by nonprofit institutions
- o Repeal the deduction for excess ~~bad-debt~~ reserves
- o Reduce the exclusion for long-term capital gains to 50 percent

In the following cases, the measures that the Congress has taken to raise taxes or to reduce the benefits from tax preferences have been less far-reaching than CBO options to:

- o Tax all corporate income at the same rate*
- o Reduce itemized deductions across the board*
- o Eliminate private-purpose tax-exempt bonds*
- o Repeal the possessions tax credit*
- o Adjust the rate structure and broaden the base of estate and gift taxes*
- o Increase energy taxes*
- o Increase excise taxes on tobacco and alcoholic beverages*
- o Reduce tax credits for rehabilitating older buildings*
- o Limit consumer interest deductions
- o Repeal energy tax incentives
- o Tax scholarship and fellowship income
- o Eliminate the extra tax exemption for the elderly and the blind

The Congress has not enacted the following options - although it has debated some and, in several cases, included them in draft legislation.

- o Amend or repeal indexing of income tax rates*
- o Eliminate or limit the deductibility of state and local property and income taxes*
- o Eliminate or limit home mortgage interest deductions*
- o Eliminate or limit charitable deductions other than for nonitemizers*

- o Impose a 5 percent tax on investment income of pension plans and individual retirement accounts*
- o Tax investment income from life insurance products*
- o Tax nonretirement fringe benefits*
- o Tax employer-paid health insurance*
- o Tax a portion of the insurance value of Medicare benefits*
- o Tax the income-replacement portion of workers' compensation and black lung benefits*
- o Phase out the dependent care credit*
- o Curtail tax subsidies for exports*
- o Impose a minimum tax on foreign-owned businesses*
- o Tax capital gains on home sales*
- o Tax capital gains held until death*
- o Increase employee contributions under the Civil Service Retirement System*
- o Tax credit unions like other thrift institutions*
- o Repeal tax preferences for extractive industries*
- o Amortize a portion of advertising costs*
- o Impose excise taxes on water and air pollutants*
- o Impose a carbon-based excise tax on fossil fuels*
- o Auction off import quotas for textiles, apparel and sugar*
- o Tax additional ozone-depleting chemicals*
- o Impose a 0.5 percent tax on the transfer of securities
- o Double the SEC fee on securities transactions
- o Tax veterans disability compensation
- o Place a per-country limit on the foreign tax credit

Details, by type of option, follow.

CBO'S OPTIONS FOR RAISING REVENUES, 1980 TO 1983, BY TYPE**I. INCREASE TAX RATES**

***Raise marginal tax rates for individuals and corporations.** Over the years, CBO's options for raising tax rates have varied with prevailing tax law. ERTA-81 reduced individual taxes across the board, lowering the top marginal rate from 70 percent to 50 percent and subjecting corporate income to a five-bracket structure, ranging from 15 percent on income of \$25,000 or less to 46 percent on income of more than \$100,000. The following year CBO put forth the option of scaling back the ERTA tax rate cuts. From then on, CBO has each year discussed and provided estimates of the revenue increases from raising marginal tax rates. The Congress enacted tax increases in 1982 and 1984, but did not raise marginal rates. In 1985, CBO included in its options a proposal for a 10 percent increase in marginal tax rates for individuals, which would have raised the top rate to 55 percent. The option ran counter to prevailing proposals for tax reform. The Tax Reform Act of 1986 was revenue neutral; it lowered marginal tax rates for individuals and corporations and broadened the tax base. Marginal tax rates did not increase until the enactment of OBRA-90.

TRA-86 had provided for an explicit two-bracket rate schedule for individuals, with rates of 15 and 28 percent and with the benefits of the 15 percent bracket and the personal exemption phased out at specified levels. The resulting marginal tax rates immediately prior to the passage of OBRA-90 for returns with no additional personal exemptions were 28 percent for income over \$185,730 (joint) and over \$109,100 (single); 33 percent (28 percent plus a 5 percent surtax to phase out the benefits of the 15 percent bracket and personal exemptions) for incomes between \$78,401 and \$185,730 (joint) and \$47,051 and \$109,100 (single); 28 percent for incomes between \$32,451 and \$78,400 (joint) and \$19,451 and \$47,050 (single); and 15 percent for incomes up to \$32,450 (joint) and \$19,450 (single). TRA also provided for a three-bracket corporate rate structure of 15 percent for income up to \$50,000; 25 percent for income between \$50,000 and \$75,000; and 34 percent for income above \$75,000.)

Following passage of TRA, CBO put forth the option of raising marginal tax rates for individuals to 16 percent and 30 percent; CBO also provided estimates of revenue gains from replacing the implicit 33 percent tax bracket with an explicit 33 percent rate on all income above the start of the phaseout of the 15 percent bracket. In 1988, CBO added to its options a 5 percent

surtax on individual taxes, and in 1990, CBO added a 38 percent top rate to its options for raising individual taxes. For corporations, CBO offered a proposal for raising the top rate to 35 percent, with an option for a 5 percent surtax.

OBRA-90 raised the top marginal tax rate for individuals to 31 percent (and eliminated the 5 percent surtax imposed to phase out the benefits of the 15 percent bracket). Under OBRA-90, the individual rate structure had three brackets: 15 percent, 28 percent, and 31 percent. OBRA-90 also phased out the personal exemption for single taxpayers whose AGI was above \$100,000, for heads of households whose AGI was above \$125,000, and for joint filers whose AGI was above \$150,000. **OBRA-93** added a fourth bracket at 36 percent for individual taxable income over \$140,000 (joint), \$127,500 (single head of household), and \$115,000 (single) and a 39.6 percent bracket on taxable income over \$250,000. OBRA-93 also increased the top corporate tax rate to 35 percent for taxable income above \$10 million.

***Raise the alternative minimum tax (AMT) rate for individuals and corporations.** CBO presented options for raising AMT rates for corporations in 1985 and 1986. The option called for expanding the existing add-on corporate minimum tax or replacing it with an AMT. At the time, the add-on minimum tax for corporations was 15 percent. TEFRA-82 had repealed the add-on tax for individuals and restructured the AMT, adding new preferences and setting the rate at 20 percent. In 1986, CBO proposed increasing the rate or expanding preferences under the AMT for individuals. **TRA-86** expanded the AMT for individuals and increased the rate to 21 percent. The changes in the corporate minimum tax were even more far-reaching. TRA replaced the 15 percent add-on tax for corporations with a 20 percent AMT that included many more preferences.

In 1988, CBO proposed increasing the AMT to 25 percent for individuals and corporations. **OBRA-90** raised the AMT rate for individuals to 24 percent.

In February 1993, CBO's options for reducing the deficit included raising the AMT from 24 to 28 percent for individuals and from 20 to 25 percent for corporations. **OBRA-93** increased the AMT rate for individuals to 26 percent for AMT income of less than \$175,000 and to 28 percent for income above \$175,000; it also increased the AMTI exemption from \$40,000 to \$45,000 for joint filers and from \$30,000 to \$33,750 for single filers.

In recent years, CBO's options for increasing the AMT reflect the judgment that the regular tax rates and the AMT rates should more or less in their present alignment. Hence, options for increasing the AMT are paired with options for increasing regular tax rates.

***Tax all corporate income at 34 percent.** CBO has on several occasions put forth the option of eliminating graduated rates for corporations or reducing the benefits from them. In 1980, the CBO option was to increase tax rates on the first \$100,000 of corporate income. **DEFRA-84** limited the benefit of the graduated rate structure to corporations with incomes below \$1,405,000. **TRA-86** further limited the benefit by phasing it out for corporations with more than \$335,000 of taxable income. Under current law, reduced corporate tax rates apply only to the first \$75,000 of income. CBO dropped the option after 1986 and reintroduced it in 1992.

***Amend or repeal indexing of income tax rates.** ERTA adjusted income tax brackets, the zero bracket amount, and the personal exemption for increases in the CPI beginning in 1985. CBO's options to amend or repeal indexing date from 1985. TRA-86 indexed the new rate brackets, the standard deduction and the personal exemption to inflation. Indexing remains in effect.

Options no longer current:

Eliminate income averaging; disallow income averaging for former students. CBO first put forth the option in 1983. To stem revenue losses, **DEFRA** in 1984 changed the rules for income averaging. It reduced the averaging period for determining base income, increased the percentage of base income above which actual earnings could be averaged, and provided that tax on averaged income be computed as if spread over four, rather than five years. **TRA-86** eliminated income averaging.

Eliminate extra tax exemption for the elderly and the blind. CBO dropped the option, first put forth in 1981, after passage of **TRA-86**, which replaced the extra exemption with an increased standard deduction for the elderly and the blind.

Repeal extra-parental personal exemption for students over 19. No action. CBO presented options for limiting the exemption in 1981 and for repealing it in 1982 and 1983. The options were subsequently dropped. In 1988, the Congress eliminated the exemption for students over 23.

Impose a 5 percent surtax on net business receipts. No action. CBO presented this option in 1990 and subsequently dropped it.

II. LIMIT ITEMIZED DEDUCTIONS UNDER THE INCOME TAX

***Reduce itemized deductions across the board.** The option dates from the early 1980s and currently is to limit the tax benefit of itemized deductions to 15 percent. **OBRA-90** reduced itemized deductions by an amount equal to 3 percent of a taxpayer's adjusted gross income over \$100,000 (excluding medical expenses, casualty and theft losses, and investment interest). In no event, however, are otherwise allowable deductions reduced by more than 80 percent.

***Limit or eliminate the deductibility of state and local taxes.** In 1983, CBO proposed eliminating state and local sales taxes. Two years later, CBO proposed eliminating state and local income, real and personal property, and sales taxes. **TRA-86** repealed the deduction for state and local sales taxes.

***Limit or eliminate charitable deductions.** The first option dates from 1983 and called for limiting the charitable deduction for nonitemizers to \$100. In 1985, CBO proposed repealing completely the charitable deduction for non-itemizers and limiting itemized charitable deductions to contributions over 2 percent of AGI. **TRA-86** eliminated the charitable deduction for non-itemizers and limited deductions of appreciated property to their tax basis. A subsequent change in law now permits taxpayers to deduct the fair market value of a contribution of appreciated property that they have held for more than 12 months. Despite the reversal, CBO continues to put forth the option of limiting deductions for appreciated property to their tax basis. The other current options are to eliminate charitable deduction or to limit them to contributions above 2 percent of AGI.

***Limit or eliminate home mortgage interest deductions.** Options to limit deductions for mortgage interest date from CBO's first set of budget reduction proposals in 1980. The options have included limiting the deductions to a specified dollar amount (which varied over the years), limiting the value of the deductions to 15 percent, and phasing out deductions for second homes. **TRA-86** limited interest that individual taxpayers could deduct on debt secured by a principal or second residence to the purchase price of the property and improvements, plus debt for medical and educational expenses. **OBRA-87** limited deductible interest (a) on debt to acquire or improve a principal or second residence, or both, to \$1 million and (b) on other debt secured by a principal or second residence to \$100,000.

Other related options advanced before passage of TRA-86 were:

Limit interest deductions. The specifics of these options have varied from year to year. For example, the option in 1981 was to terminate deductibility of consumer interest. In 1985, it was to limit itemized interest deductions for all purposes, including mortgages, to \$10,000 over investment income for joint returns and to \$7,500 for others. At the time, the law permitted deductions for all interest payments on home mortgages, auto loans, credit card balances, and other consumer borrowing. In addition, it permitted deductions for interest on borrowing for investment purposes (such as the purchase of stock) up to \$10,000 in excess of investment income. **TRA-86** phased out over a 5-year period the deduction for non-mortgage consumer interest. TRA also limited deductions for investment interest to amounts that did not exceed investment income.

Combine miscellaneous deductions and employee business expense deductions and subject them to a floor of 1 percent of AGI. This option was put forth early in 1986. Under **TRA-86**, employee business expenses are allowed only as itemized deductions and, with miscellaneous deductions, are subject to a floor of 2 percent of AGI. Previously, **TEFRA-82** had limited deductions for nonbusiness casualty losses to amounts exceeding 10 percent of the taxpayer's AGI. **DEFRA-84** modified the rules for reporting net personal casualty gains and losses.

Limit deductions for medical expenses. Options to reduce deductions for medical expenses date from 1980. In 1985, the option was to allow medical expense deductions only for costs over 10 percent of AGI. **TEFRA-82** increased the floor for deductible medical expenses from 3 to 5 percent of AGI, removed the separate floor of 1 percent of AGI for prescription drugs, and eliminated the separate deduction for health insurance premiums. **TRA-86** increased the floor under the medical expense deduction from 5 percent to 7.5 percent. **OBRA-90** eliminated the medical deduction for cosmetic surgery.

III. RESTRICT THE TAX-FAVORED TREATMENT OF INCOME FROM EMPLOYMENT AND HOUSEHOLD INVESTMENTS

***Increase taxation of Social Security and Railroad Retirement benefits.** CBO first presented options for taxing 50 percent of Social Security benefits in 1980. The options included taxing all recipients or only those with incomes above specified levels. The **Social Security Amendments of 1983** made extensive changes in OASDI programs, including subjecting 50 percent of Social Security benefits to taxation for recipients with incomes above specified levels. Subsequent CBO options were to increase the percentage of benefits subject to taxation and to eliminate the income thresholds. The options in February 1993 were either to increase the fraction of benefits included in AGI so as to tax up to 85 percent of benefits or to eliminate or reduce the income thresholds. **OBRA-93** subjects to the income tax up to 85 percent of Social Security and Railroad Retirement benefits for taxpayers whose other income plus one-half of their Social Security benefits exceeds \$34,000 for single filers or \$44,000 for joint filers. CBO's current options would affect beneficiaries whose income falls below these thresholds.

***Decrease limits on contributions to qualified pension and profit-sharing plans.** In February 1993, CBO presented two options: (1) decrease limits for defined benefit plans to the Social Security wage base (with equivalent reductions for defined contribution plans); and (2) to decrease the limit for deferrals in salary reduction plans (401(k) deferrals) to \$4,000. These options have changed little since 1987. Current law limits defined benefit plans to 100 percent of wages or \$115,641 for 1993, whichever is less. Limits on defined contribution plans are 25 percent of compensation, or \$30,000, whichever is less. The limit on the amount of compensation that can be taken into account for purposes of determining an employer's contributions or the amount of a participant's benefits from a retirement plan is \$235,840 for 1993 (the amount is indexed annually for inflation). Limits on 401(k) deferrals were \$8,994 for 1993. **OBRA-93** reduced the limit on compensation taken into account under a defined benefit or contribution plan from the current level of \$235,840 to \$150,000 for 1994. As under current law, this limit is to be indexed annually for inflation. OBRA-93 did not address any of the other limits on retirement plans.

CBO's options before tax reform included repealing 401(k) plans or lowering the maximum contribution and decreasing maximum limits on pension contributions and pension benefits. **TEFRA** reduced the maximum annual addition to a defined contribution plan from \$45,000 + (\$25,000 plus

cost of living adjustments since 1974) to \$30,000 and the maximum annual benefit under a defined benefit plan from \$136,000+ (\$75,000 plus cost of living adjustments) to \$90,000 for employees whose pensions began at age 62. TEFRA also suspended cost of living adjustments until 1986; limits were then to be adjusted for post-1984 increases. **DEFRA** postponed cost of living increases until 1988.

In early 1986, CBO proposed repealing 401 (k) plans or lowering the maximum contribution to \$7,000 and decreasing maximum limits on pension contributions from \$30,000 to \$15,000 and pension benefits from \$90,000 to \$60,000. **TRA-86** lowered the cap on employee deferrals in salary reduction arrangements to no more than \$7,000 in the case of 401 (k) plans, SEPs, and the federal plan, and to no more than \$9,500 for 403(b) tax-sheltered annuities. The \$7,000 limit was set for 1987 and indexed to inflation beginning in 1988. For participants in employer-maintained retirement plans, TRA-86 phased out deductible IRA contributions for individuals with incomes above \$35,000 and married couples with incomes above \$50,000. The phase-out ranges began at \$25,000 for individuals and at \$40,000 for joint filers. TRA also modified the limits on employer-sponsored defined benefit and defined contribution pension plans. TRA maintained the limit on contributions to defined benefit plans at the lesser of 25 percent of compensation or \$30,000 a year. The limit on defined contribution plans was set at the lesser of 100 percent of wages or \$90,000 for employees whose pensions began at age 65; the limit for employees retiring at an earlier age was reduced to the actuarial equivalent of an annual benefit of \$90,000 beginning at age 65.

***Eliminate Private-Purpose Tax-Exempt Bonds.** CBO's first options for limiting or eliminating private-purpose tax-exempt bonds date from 1980. A few years later, CBO also proposed disallowing interest deductions for bank holdings of tax-exempt bonds. **The Mortgage Subsidy Bond Act of 1980** imposed limits on mortgage revenue bonds. The **Education Amendments of 1980** placed no limits on student loan bonds, but reduced by one-half the special allowance paid on loans originating from the proceeds of tax-exempt bonds. Both pieces of legislation followed the publication of CBO studies. Subsequently, all major tax acts from TEFRA-82 to TRA-86 included restrictions on private-purpose tax-exempt financing. More recent legislation, however, has relaxed restrictions by extending the use of bonds that had previously been scheduled to expire.

TRA-86 prohibited the use of private-purpose tax-exempt financing for some activities, such as pollution control, and placed a single state-by-state limit on the volume of new issues of **IDBs**, student loan bonds, and housing

and redevelopment bonds. The limits were the greater of \$75 per resident or \$250 million a year through 1987 and \$50 per resident and \$150 million a year thereafter. The limits remain unchanged. TRA-86 also sharply restricted interest deductions for bank holdings of tax-exempt securities. Under the provisions of TRA-86, tax-exemption for MRBs and for small issue IDBs was to have terminated at the end of 1988 and 1989, respectively. The dates were extended under OBRA-89 and OBRA-90, and under OBRA-93, MRBs and small issue IDBs for manufacturers and first-time farmers were made permanent. DEFRA had put a state-by-state cap on IDBs of the greater of \$250 million or \$150 a person (\$100 after 1986); enacted restrictions on arbitrage profits; and strengthened the requirement for straight-line depreciation of property financed with tax-exempt bonds. TEFRA had previously barred property placed in service and financed with tax-exempt bonds from qualifying for any accelerated cost recovery (but permitted the use of the ACRS depreciation periods). TEFRA also repealed the exemption for small issue bonds issued after 1985.

***Impose a 5 percent tax on investment income of pension plans and individual retirement accounts.** CBO has advanced this option since 1987. No action.

Tax investment income from life insurance products. CBO has put forth this option since 1988. No action.

***Tax nonretirement fringe benefits.** CBO has put forth this option since 1982. No action.

***Tax the income-replacement portion of workers' compensation and black lung benefits.** CBO has put forth this option since 1988. No action.

***Phase out the dependent care credit.** This has been a deficit reduction option since 1988. No action.

Options no longer current include:

Repeal the dividend exclusion (\$100/\$200). This was among CBO's budget reduction options in 1985 and 1986. TRA-86 repealed the dividend exclusion.

Tax all unemployment compensation. The proposal was initially made in 1980. TEFRA-82 lowered the income levels for the exclusion of

unemployment compensation benefits. **TRA-86** made unemployment compensation fully taxable.

Repeal the tax credit for employee stock ownership plans; include ESOP cash dividends in the Social Security tax base. CBO first advanced the option of repealing the ESOP tax credit in 1983. **TRA-86** repealed the special payroll-based ESOP tax credit for compensation paid or accrued after December 31, 1986. **OBRA-89** restricted deductibility of ESOP dividends paid by corporations. CBO put forth the option to include ESOP cash dividends in the Social Security tax base in 1991 and subsequently dropped it.

Repeal net interest exclusion. **ERTA-81** permitted taxpayers after 1984 to exclude 15 percent of net interest received up to \$3,000 (\$6,000 on a joint return). **DEFRA-84** repealed the exclusion.

Tax scholarship and fellowship income. CBO first presented this option in 1982. **TRA-86** limited the exclusion to degree candidates and to amounts for tuition, books, supplies and equipment and eliminated the exclusion for room, board, or incidental expenses. It also provided that the exclusion would not apply to grants or tuition reductions for teaching, research, or other services.

Tax cash allowances and the rental value of housing provided to persons in the uniformed services and the clergy. No action. This was a CBO option for only one year—1986. **TRA-86** reaffirmed and reinforced the preference by providing a permanent rule that ministers receiving parsonage allowances and military personnel receiving military housing allowances that are excluded from income are not precluded from deducting mortgage interest or real property taxes on their residences.

IV. RESTRICT THE TAX-FAVORED TREATMENT OF HEALTH BENEFITS

***Tax employer-paid health insurance.** No action. The option dates from 1980.

Tax a portion of the insurance value of medicare benefits. No action. CBO has advanced the option since 1985.

V. INCREASE TAXES ON INCOME FROM WORLDWIDE ACTIVITY

***Repeal the possessions tax credit.** The credit effectively exempts from taxation income earned by U.S. corporations operating in Puerto Rico or other U.S. possessions. CBO has presented an option for its repeal since 1981. **OBRA-93** limited, but did not repeal the possessions tax credit, effective January 1, 1994. U.S. corporations may choose between limits based on a percentage of the credit that would be allowed under current law and limits based on economic activity in the possession. Under the first alternative, the allowable credit gradually declines from 60 percent of the current law credit in 1994 to 40 percent in 1998 and thereafter. Under the second alternative, the credit is limited to the sum of 60 percent of wages and fringe benefits paid in the possession and specified percentages of depreciation deductions (15 percent of depreciation deductions on short-life tangible property, 40 percent on medium-life property, and 65 percent on long-life property).

***Curtail tax subsidies for exports.** This is a broader version of a option that goes back to 1980 and called for the elimination of DISCs (domestic international sales corporations). DISCs were tax-exempt subsidiary corporations established as conduits for export sales. The device permitted the parent firm to shelter from taxation as much as 33 percent of its income from export sales. Under DEFRA-84, and in response to criticism from the signatories of the GATT, DISCs were replaced by FSCs (foreign sales corporations). FSCs are foreign-incorporated subsidiaries of U.S. corporations, which must meet certain foreign-presence and processing requirements, but are nonetheless essentially paper entities. A portion of the export income of a FSC is exempt from U.S. taxation.

***Impose a minimum tax on foreign-owned businesses.** CBO advanced this option in 1993 at the request of the House Budget Committee.

Options no longer current:

Place a per-country limit on the foreign tax credit. No action.
Proposed in 1985 and subsequently dropped.

VI. BROADEN TAXES ON WEALTH AND CAPITAL GAINS

***Adjust the rate structure for estate and gift taxes.** In 1983, CBO presented an option for freezing the estate and gift credit at the exemption equivalent of \$275,000 (the level then current). The option was repeated in 1984 and then dropped. In 1993, CBO proposed adjusting the rate structure for estate and gift taxes either by raising statutory rates or by lowering the unified credit, which effectively exempts the first \$600,000 from taxation. The top rate on estate and gift transfers was reduced from 55 to 50 percent beginning in 1993. In 1992, the top rate applied to estates of more than \$3 million; an intermediate rate of 53 percent applied to estates amounting to between \$2.5 and \$3 million. **OBRA-93** reinstated the top estate and gift tax rates at 53 percent and 55 percent.

CBO also presented options for broadening the base of estate and gift taxes by including life insurance proceeds and reducing the federal offset to state inheritance taxes. The Congress has not acted on the base-broadening options.

***Tax capital gains from home sales.** No action. Current law allows taxpayers to defer paying capital gains from home sales if they purchase another home of equal or greater value within two years and permits taxpayers over 55 to exclude up to \$125,000 of gain from one home sale, even if they do not purchase another home. CBO has presented options for reducing the exclusion since 1980. The option in 1982 was to tax 10 percent of the capital gains on home sales. It is now 30 percent. An alternative option, introduced in 1990, is for all taxpayers to include lifetime gains in excess of \$125,000 of taxable income when realized.

***Tax capital gains held until death.** No action. CBO has put forth this option since 1985.

Options no longer current:

Reduce the exclusion for long-term capital gains to 50 percent. Proposed in 1985. **TRA-86** eliminated the exclusion for long-term capital gains, but limited the top marginal tax rate on gains to 28 percent.

VII. INCREASE TAXES DEDICATED TO SOCIAL INSURANCE TRUST FUNDS

***Expand Social Security Coverage.** CBO has put forth options for expanded coverage since 1982. CBO's initial options were for extending Social Security coverage to new government employees. The **Social Security Amendments of 1983** required federal workers hired after December 31, 1983, and all nonprofit employees to contribute to the OASDI trust fund. **OBRA-90** extended Social Security to state and local employees without pension coverage.

***Broaden the Medicare tax base.** CBO's initial options date from 1982 and called for imposing the Medicare tax on federal employees. **TEFRA** required federal workers to contribute to Medicare beginning in 1983. Employees of state and local governments hired after March 31, 1986, are also liable for the HI Tax. Ever since the passage of TRA-86, CBO has proposed extending HI coverage to state and local government employees not covered.

From 1988 to 1993, CBO also proposed repealing the maximum taxable earnings level for Medicare. **OBRA-90** increased the Medicare wage cap to \$125,000. **OBRA-93** repealed the maximum taxable earnings level for Medicare effective January 1, 1994.

***Increase Employee Contributions Under the Civil Service Retirement System.**

CBO first advanced this option in 1982; dropped it in 1983; and picked it up again in 1993.

VIII. CURTAIL INCOME TAX PREFERENCES FOR BUSINESSES

***Reduce tax credits for rehabilitating older buildings.** CBO introduced the option in 1984. **TRA-86** replaced a three-tier rehabilitation tax credit ranging from 15 percent to 25 percent with a two-tier credit of 10 percent for expenditures on structures built before 1936 and 20 percent for buildings certified as historic structures by the Department of the Interior. The current option is to repeal the credit entirely or to reduce the credit for historic structures to 15 percent and to repeal it for nonhistoric structures.

***Tax credit unions like other thrift institutions.** No action. CBO first put forth the option in 1985.

***Repeal tax preferences for extractive industries.** The first options date to 1980 and included repealing the percentage depletion allowance for oil and gas and repealing expensing of oil and gas intangible drilling costs. TRA-86 imposed minimal restrictions on percentage depletion and intangible drilling costs.

***Amortize a portion of advertising costs.** No action. The option dates from 1990.

Options no longer current:

Restrict deductions for business meals and entertainment. CBO first advanced the option to restrict deductions for business meals and entertainment from 100 percent to 50 percent of expenses in 1983. **TRA-86** limited deductions for business meals and entertainment to 80 percent of expenses. **OBRA-93** restricted deductions for business meals and entertainment to 50 percent of expenses.

Mark securities dealers' inventories to market value. Under prior law, dealers in securities could value for tax purposes their inventories of securities held for sale based on: (1) the cost of securities; (2) the lower of the cost or the market value of securities; or (3) the market value of the securities. This effectively permitted them to deduct from taxable income accrued losses on year-end inventories and to defer paying taxes on accrued gains until the year of sale. **OBRA-93** requires, effective January 1, 1994, that securities dealers' inventories be valued at market prices and that accrued losses and gains be taken into account in determining gross income for the taxable year.

Revise depreciation rules, put forth in 1985 and 1986, before the passage of TRA-86. Under ERTA, the cost of depreciable property could be recovered over periods of 3, 5, or 15 years, using the 150 percent declining balance method, with a switch to straight-line when that method would result in a larger recovery. The CBO option, which was substantially enacted in 1986, was to more closely match tax and economic depreciation. **TRA-86** modified the accelerated cost recovery system and increased recovery periods for depreciating property. Generally, TRA provided for a more accelerated method for depreciating most machinery and equipment and a less accelerated method for depreciating structures. (A CBO option to **lengthen building depreciation from 15 to 20 years** was put forth in 1984,

before passage of DEFRA. **DEFRA** increased the depreciation period for real property, other than low-income housing, to 18 years. **TRA** increased the depreciation period to 27.5 years for residential structures and 31.5 years for nonresidential structures. **OBRA-93** lengthened the depreciation period for nonresidential structures from 31.5 to 39 years.)

Restrict use of the cash method of accounting. With certain exceptions, **TRA-86** prohibited the use of the cash method of accounting by any C corporation, partnership that has a C corporation as a partner, tax shelter, or tax-exempt trust with unrelated business income.

Extend the at-risk limitation. CBO put forth the option in 1985. **TRA-86** extended the at-risk rules to the activity of holding real property, with certain exceptions.

Restrict tax-motivated leasing by nonprofit institutions. Put forth in 1984, before passage of DEFRA, which reduced tax-motivated leasing by sharply curtailing the benefits from the sale and leaseback of real property. **TRA-86** repealed finance leasing.

Repeal the deduction for excess bad-debt reserves. Presented in 1984, before passage of DEFRA. **TRA-86** generally repealed the reserve method of computing deductions for bad debts, other than for commercial banks and thrifts with assets of less than \$500 million.

Eliminate the ITC or require a full basis adjustment for it. The option, put forth in 1983 before passage of DEFRA, was to require full basis adjustment for the ITC. TEFRA-82 had required a partial basis reduction for the rehabilitation credit and the regular and energy investment credits. The option was modified in 1985 and 1986, before passage of TRA. **TRA-86** repealed the ITC.

Repeal energy tax incentives (business and residential). Proposed before passage of DEFRA-84. **TRA-86** permitted most energy credits to expire. It did, however, extend some energy credits for businesses: the solar energy tax credit was extended for three years at 15 percent in 1986, 12 percent in 1987 and 10 percent in 1988; the ocean thermal energy credit, for three years at 15 percent; the biomass energy credit, for two years at 15 percent in 1986 and 10 percent in 1987; and the ocean thermal energy credit, for three years at 15 percent. **OBRA-90** repealed the ocean thermal credit. Current energy credits

are limited to business investment in solar and geothermal energy equipment. In addition, the Energy Act of 1992 permits a 1.5-cent credit per kilowatt hour for electricity provided from qualified wind energy or "closed loop" biomass.

Match income with expense for multiperiod construction. Substantially enacted in **TRA-86**. Subsequent legislation enacted aspects of the option dealing with long-term contracts.

Repeal the credit for incremental research expenditures. Advanced in 1984 before passage of DEFRA. **TRA-86** extended the credit for three years through 1988, but reduced the rate from 25 to 20 percent and made rental and similar payments for personal property ineligible for the credit. The credit remains in effect in somewhat modified form.

Eliminate the accumulated earnings allowance for personal service corporations. Proposed in 1983, but not subsequently.

Modify tax treatment of foreign oil and gas income. No action. Proposed in 1982, but not subsequently.

Limit eligibility for the targeted jobs tax credit, making it unavailable for cooperative education students. Proposed in 1981, but not subsequently. The credit was due to expire after 1982, but was subsequently extended several times.

IX. INCREASE EXCISE TAXES, SALES TAXES AND MISCELLANEOUS FEES

***Impose a value-added or national sales tax.** CBO has been pointing out the revenue-raising potential of a VAT or a national sales tax since 1982. No action.

***Increase Energy Taxes.** In 1993, CBO presented five options: (1) impose a \$5 per barrel tax on domestic and imported oil; (2) impose a \$5 per barrel oil import fee; (3) increase motor fuel taxes by 12 cents per gallon; (4) increase motor fuel taxes by 10 cents per gallon each year for five years; and (5) impose a broad-based tax on energy consumption (5 percent of value). This option goes back to 1983 and has been virtually unchanged since 1985. CBO has also called for extending the gas guzzler tax to more vehicles.

The Clinton Administration supported a broad-based tax on energy consumption, which passed in the House, but failed in the Senate. Instead, **OBRA-93** increased the transportation fuels tax by 4.3 cents per gallon. It also extended the additional **2.5-cents-per-gallon** motor fuels tax scheduled under current law to expire on September 30, 1995, to September 30, 1999. This tax, which now goes into the general fund, will (for the most part) be transferred to the Highway Trust Fund beginning October 1, 1995. The additional tax on diesel fuels for trains will be reduced from 2.5 cents a gallon to 1.25 cents a gallon as of October 1, 1995, and will continue to go into the general fund.

OBRA-90 imposed a 5 cent-a-gallon increase in the gasoline tax, with half going to the general fund and half to the Highway Trust Fund. OBRA-90 also doubled the gas guzzler tax.

Previous options have included repealing exemptions to the gasoline excise tax-specifically, the gasohol exemption and credit and the bus exemption.

***Increase excise taxes on tobacco and alcoholic beverages.** CBO first discussed increases in alcoholic beverage and tobacco taxes in 1982. The current option calls for an increase in excise taxes on distilled spirits to \$16 per proof gallon and for an increase in the cigarette tax to 48 cents a pack.

(a) Alcoholic beverages: **OBRA-90** increased taxes on beer to 32 cents per six-pack, on distilled spirits by \$1 to \$13.50 per proof gallon, and on table wine (14 percent alcohol or less) by 21 cents per 24-ounce bottle. **DEFRA-84** had increased the tax on distilled spirits to \$12.50 per proof gallon effective October 1, 1985. This was the first increase in the distilled spirits tax since 1951, when the rate was set at \$10.50 per proof gallon.

(b) Tobacco: OBRA-90 increased all tobacco taxes by 25 percent. The tax on cigarettes went up by 4 cents a pack in 1991 and an additional 4 cents a pack in 1993 and is currently 24 cents. **TEFRA-82** had increased the cigarette tax from 8 cents per pack to 16 cents for the period from January 1, 1983, to September 30, 1985. The 16-cent rate was subsequently extended through March 15, 1986, and then made permanent.

***Impose excise taxes on water pollutants.**

*** Impose excise taxes on air pollutants.**

*** Impose a carbon-based excise tax on fossil fuels.**

Tax additional ozone-depleting chemicals. CBO introduced this option in 1993. In previous actions, unrelated to CBO's deficit reduction options, the Congress imposed a tax on ozone depleting chemicals subject to the Montreal Protocol (OBRA-89) and subsequently expanded it (OBRA-90). The Energy Policy Act of 1992 increased the tax rates on ozone depleting chemicals.

*** Auction off import quotas for textiles, apparel and sugar.** Under the Uruguay Round of the General Agreement on Tariffs and Trade, now in its final phase of negotiation, quotas for textiles and apparel will be phased out over a ten-year period and quotas for agricultural products will be converted to tariffs. The agreement would go into effect on July 1, 1995; revenue gains from auctioning off import quotas would thus be reduced.

Options no longer current:

Increase and extend telephone excise taxes. This proposal was among CBO's budget reduction options in 1982. **OBRA-90** permanently extended a 3 percent telephone excise tax that was enacted under **TEFRA-82** and was subsequently extended through 1987 under **DEFRA-84** and again through 1990.

Increase aviation-related excise taxes, initially presented in 1990. **OBRA-90** increased and extended aviation-related excise taxes dedicated to the Airport Trust Fund. (It also increased taxes dedicated to the Harbor Maintenance Trust Fund and extended taxes dedicated to the Leaking Underground Storage Tank Trust Fund and the Superfund). **OBRA-89** had increased the international air passenger departure tax from \$3 to \$6.

impose a 0.5 percent tax on the transfer of securities. Proposed in 1990.

Double the SEC fee on securities transactions from 1/300th of 1 percent of the dollar value of certain securities sales. No action. Proposed in 1992.

Levy a windfall profits tax on natural gas. No action. CBO advanced this idea in 1982 and 1983 and subsequently dropped it.

X. COMPLIANCE

Options no longer current:

Withhold 15 percent of income from interest and dividends. CBO first put forth an option for withholding of income from interest and dividends in 1980. TEFRA required financial institutions and other businesses to withhold 10 percent of interest and dividends earned by individuals beginning July 1, 1993. TEFRA also increased information reporting and provided for optional withholding on pensions, annuities and lump sum distributions. The provision for withholding on interest and dividends was subsequently repealed and replaced by a less comprehensive system of withholding for taxpayers who fail to provide identifications or fail to report interest or dividend income.

Withhold 10 percent of independent contractor income. The option was first advanced in 1980 and dropped after 1985.

Increase IRS audit and collection resources. The option was first advanced in 1980 and dropped after 1986. CBO has not attributed revenue increases to any bills increasing appropriations to IRS for enforcement initiatives. Therefore, the option is inappropriate as a possible deficit reduction measure.