CONGRESSIONAL BUDGET OFFICE
U.S. Congress
Washington, DC  20515

Peter R. Orszag, Director

July 9, 2008

Honorable Patrick T. McHenry
U.S. House of Representatives
Washington, DC 20515

Dear Congressman:

This letter responds to your May 21 inquiry concerning CBO's contrasting cost estimates for S. 625 and H.R. 1108, the Family Smoking Prevention and Tobacco Control Act.  You note that the two bills, otherwise very similar, are scored differently with respect to the estimate of fees that must be collected to defray the net loss to the Treasury caused by the bill's effects on receipts from income and payroll taxes.  You point out that this difference springs from the House bill's direction to classify the new fees imposed on tobacco producers and importers as "offsetting receipts" instead of revenues.

The differences in how the budget effects are scored reflect the language in H.R. 1108 specifying how to classify governmental collections.  That difference reflects longstanding Congressional budget scoring procedures but does not reflect a real underlying difference in the effect of the two bills on the budget; in reality, for fees set at the same levels, the net effects on the government's receipts would be the same, regardless of how they are recorded in the budget.

CBO expects that the Family Smoking Prevention and Tobacco Control Act would affect federal collections through three channels.  First, the reduction in tobacco consumption that is the bill's goal would reduce collections from tobacco excise taxes.  Second, the imposition of an assessment on tobacco producers and importers would raise revenue to compensate for the loss of those excise tax receipts and to cover the costs of the FDA's new regulation of the industry.  And third, the imposition of that assessment would lower taxable income, leading to a loss of payroll and corporate and individual income taxes.

This last effect is characteristic of excise taxes, customs duties, and miscellaneous fees. CBO, the Treasury Department, and the Joint Committee on Taxation generally estimate the loss in income and payroll taxes to equal 25 percent of the collections resulting from imposing indirect taxes or fees. Consequently, many proposals that impose such fees increase them enough both to cover the outlays that they are designed to finance and to make the Treasury whole for the losses in other taxes. That was the case with S. 625.

Unlike indirect taxes, most offsetting receipts (a credit against direct spending) and offsetting collections (a credit against discretionary appropriations) do not result from the exercise of the federal government's sovereign power to require payments from the public. They are generally the consequence of business-like activities of the government, in which firms or individuals voluntarily purchase services. They include, for example, receipts from the sale of postage stamps and electricity, Medicare premiums, charges for admittance to national parks, premiums for deposit insurance, and the sale or lease of assets. They do not appear as revenues in the budget; but instead appear as a credit (or offset) against outlays, defraying the cost of providing the services.

Such purchases from the government do not typically have adverse effects on other government receipts because they either replace similarly deductible business outlays to alternative providers of the same service (for example, receipts from the sale of timber), or they represent payments for an entirely new service that is generating new income to be taxed (for example, receipts from the auction of licenses for use of the electromagnetic spectrum). Consequently, in most cases, the creation of a new offsetting receipt or collection does not result in the kind of revenue loss from other tax sources that occurs when a new indirect tax or fee is levied.

Because the revenue effects of taxes and offsetting receipts or collections are conceptually different, they are accounted for differently in cost estimates. Thus, by longstanding Congressional scorekeeping practice, the 25 percent offset that is applied to indirect taxes is not applied to offsetting receipts or collections. On occasion, legislation will designate as an offsetting receipt a payment that otherwise meets the definition of arevenue. Though that designation does not change the substantive nature or economic effect of such payments, the practice of not applying a 25 percent offset to offsetting receipts or collections results in an estimate of receipts that is higher—for a given assessment rate—than would result if they were classified as revenues.

The tobacco legislation to which you refer is not the first instance in which this issue has arisen. A number of fees are currently recorded in the federal budget as offsetting receipts or collections, even though that treatment is contrary to principles set forth in the 1967 *Report of the President's Commission on Budget Concepts*. The commission recommended that "receipts from activities which are essentially governmental in character, involving regulation or compulsion, should be reported as receipts" (that is, as revenues, rather than as offsets to expenditures). Nonetheless, on a number of occasions, the Congress has directed in legislation that some new collections of a governmental character be recorded as offsets on the expenditure side of the budget. These include, for example, customs user fees, State Department passport and immigration fees, and pre-merger fees levied by the Federal Trade Commission. (Pursuant to another longstanding practice, some other collections of a governmental nature are recorded on the spending side of the budget for a different reason: If they are triggered by language in an appropriation bill, they are treated as offsets to discretionary appropriations.)

I hope this information is helpful to you, and I would be happy to answer any other questions you may have.

Sincerely,

Peter R. Orszag
Director

cc: Honorable John D. Dingell
Chairman
Committee on Energy and Commerce

Honorable Joe Barton
Ranking Member

Honorable John M. Spratt Jr.
Chairman
Committee on the Budget

Honorable Paul Ryan
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Honorable Edward M. Kennedy
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Senate Committee on Health, Education, Labor, and Pensions

Honorable Mike Enzi
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Honorable Kent Conrad
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Honorable Judd Gregg
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