

The Revenue Outlook

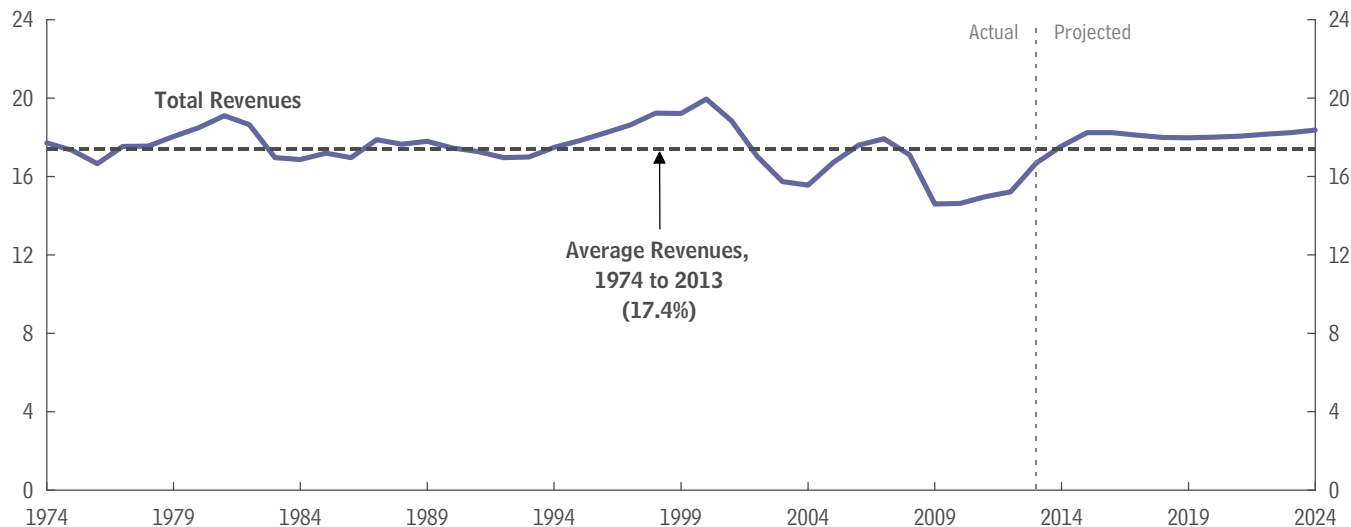
The Congressional Budget Office (CBO) projects that, if current laws generally do not change, the federal government's revenues will increase by 9 percent in 2014 and by another 9 percent in 2015, reaching \$3.3 trillion in 2015—about \$530 billion more than receipts in 2013. As a share of gross domestic product (GDP), revenues are projected to rise from 16.7 percent in 2013 to 17.5 percent (about the average for the past 40 years) in 2014 and to 18.2 percent in 2015. Because of the recent recession, revenues had fallen to 14.6 percent of GDP in both 2009 and 2010 (see Figure 4-1).

More than half of the projected growth in revenues relative to GDP between 2013 and 2015 comes from changes in provisions of law that have already occurred or are scheduled to occur. The largest contributors are the following:

- The expiration, at the end of calendar year 2013, of a number of tax provisions that reduced corporate and individual income taxes, especially one that allowed businesses to immediately deduct a significant portion of their investment in equipment.
 - A number of changes that, because they took effect in January 2013, will increase revenues more in fiscal year 2014, the first full fiscal year they are in effect, than they did in fiscal year 2013. Those changes include the expiration of a two-year reduction in Social Security payroll tax rates, as well as increases in income tax rates and a new surtax on investment income that apply to certain high-income individuals.
 - New taxes, fees, and fines related to health insurance coverage under the Affordable Care Act, although those additional revenues will be partially offset by new tax credits to subsidize the purchase of health insurance.
- Revenues are also projected to rise relative to GDP this year and next year for reasons other than changes in law. The factors that significantly reduced corporate income tax revenues during the recession have since diminished, and CBO expects them to wane further as the economy continues to recover. In addition, CBO projects that growth in people's real (inflation-adjusted) income will push more of their income into higher tax brackets, a phenomenon called real bracket creep. Moreover, CBO expects that taxable distributions from tax-deferred retirement accounts will increase faster than GDP, in part because the balances in those accounts have been boosted in the past two years by a rapid increase in equity prices, which will allow people to make larger withdrawals.
- After this year and next, revenues in CBO's baseline projections remain between 18.0 percent and 18.4 percent of GDP from 2016 through 2024, largely because of offsetting movements in three sources of revenue:
- Individual income tax receipts are projected to increase as a share of GDP, mostly as a result of real bracket creep and increases in withdrawals from tax-deferred retirement accounts as baby boomers retire.
 - Corporate income tax receipts are projected to decline relative to the size of the economy because of an expected drop in domestic economic profits relative to GDP, a result of rising interest payments on businesses' debt, growing labor costs, and increasing depreciation deductions on the larger stock of business capital.
 - Remittances to the Treasury from the Federal Reserve—which have been very large in the past four years because of changes in the size and composition of the central bank's portfolio—are projected to decline to more normal levels.

Figure 4-1.**Total Revenues**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

Last May, CBO published revenue projections for the period from 2013 to 2023; the projections in this chapter cover the period from 2014 to 2024. For the overlapping period—2014 to 2023—the current projections are lower than the previous ones by a total of \$1.6 trillion (or 4 percent). That reduction largely reflects slower GDP growth in CBO’s updated economic forecast. (For more information on changes to the revenue projections since May, see Appendix A.)

The tax rules on which CBO’s projections are based include the tax rates that apply to different types of income; they also include an array of exclusions, deductions, preferential rates, and credits, which reduce revenues, for any given level of tax rates, in both the individual and corporate income tax systems. Some of those provisions are called tax expenditures because, like government spending programs, they provide financial assistance to particular activities, entities, or groups of people. The tax expenditures that have the largest effect on revenues are the following:

- The exclusion from workers’ taxable income of employers’ contributions for health care, health insurance premiums, and long-term-care insurance premiums;
- The exclusion of contributions to and earnings of pension funds (minus pension benefits that are included in taxable income);

- Preferential tax rates on dividends and long-term capital gains; and
- The deduction of interest that homeowners pay on mortgages for their residences.

On the basis of estimates prepared by the staff of the Joint Committee on Taxation (JCT), CBO expects that under current law, those and other tax expenditures will total \$1.4 trillion in 2014—an amount equal to 8.2 percent of GDP, or nearly half of the revenues projected for the year.¹ Most of that amount arises from the 12 largest tax expenditures, which CBO estimates will total about 6.0 percent of GDP in 2014 and 6.5 percent of GDP from 2015 to 2024.

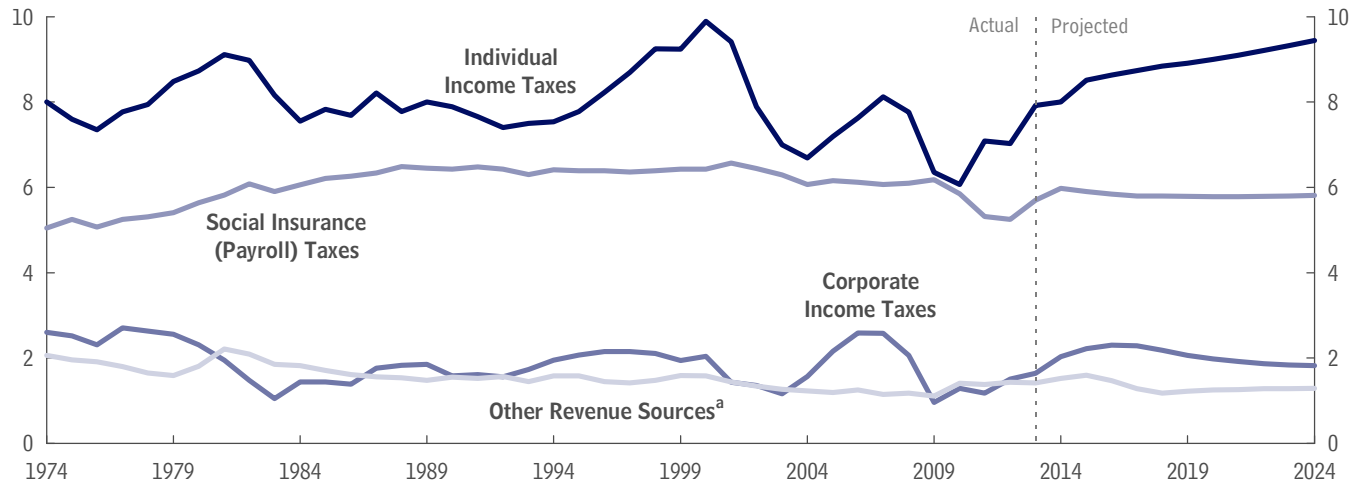
How the Composition of Revenues Is Evolving

Federal revenues come from various sources: individual income taxes; payroll taxes, which are dedicated to certain social insurance programs; corporate income taxes; excise taxes; earnings of the Federal Reserve System, which are remitted to the Treasury; customs duties; estate and

1. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), <http://go.usa.gov/ZHCz>. CBO used its economic forecast to extrapolate the estimates beyond 2017 and included projected effects on payroll taxes.

Figure 4-2.**Revenues, by Major Source**

(Percentage of gross domestic product)



Source: Congressional Budget Office.

a. Excise taxes, remittances to the Treasury from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines.

gift taxes; and miscellaneous fees and fines. Individual income taxes are the largest source of federal revenues, having contributed, on average, about 45 percent of total revenues (and equaled about 8 percent of GDP) over the past 40 years. Social insurance taxes—mainly for Social Security and for Medicare’s Hospital Insurance program—are the second-largest source of receipts, averaging about 35 percent of total revenues (or 6 percent of GDP) over the same period. Corporate income taxes have contributed roughly 10 percent of total revenues (or 2 percent of GDP), as have all of the other revenue sources combined.

Although that broad picture has remained the same over the past four decades, the details have varied. Receipts from individual income taxes have fluctuated more than the other major types of revenues, ranging from 42 percent to 50 percent of total revenues (and from 6.1 percent to 9.9 percent of GDP) but showing no clear trend over that period (see Figure 4-2). Receipts from social insurance taxes rose as a share of revenues in the 1970s—largely because of legislated increases in tax rates and in the amount of income to which those taxes applied—and reached about 36 percent of total revenues (and just over 6 percent of GDP) in the mid-1980s. Since 2001, those receipts have fallen slightly relative to GDP; in addition, a sharper, temporary reduction took place in 2011 and

2012 as a result of a two-year reduction in the employees’ share of the Social Security payroll tax. Revenues from corporate income taxes fell substantially relative to total revenues and GDP in the early 1980s, mainly because of declining profits and legislation that accelerated depreciation deductions. Those revenues have fluctuated since then with no evident trend. Revenues from the remaining sources, particularly excise taxes, have slowly trended downward over the past 40 years relative to total revenues and GDP.

Under current law, CBO projects, individual income taxes will generate a growing share of revenues over the next decade; by 2021, they will account for more than half of total revenues (for the first time in history), and by 2024, they will rise to more than 9 percent of GDP, well above the historical average. Receipts from social insurance taxes are projected to remain stable at about 5.8 percent of GDP, though their share of total revenues is projected to decline slightly as revenues from individual income taxes grow more quickly. Corporate income taxes are expected to make roughly the same contribution that they have in the past three decades, supplying about 11 percent of total revenues and averaging 2 percent of GDP. Taken together, the remaining revenue sources are expected to diminish slightly as a share of total revenues, though they will remain roughly stable relative to GDP.

Table 4-1.**Revenues Projected in CBO's Baseline**

	Actual,												Total	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-2019	2015-2024
In Billions of Dollars														
Individual Income Taxes	1,316	1,381	1,542	1,647	1,752	1,851	1,948	2,051	2,161	2,279	2,403	2,533	8,741	20,168
Social Insurance Taxes	948	1,033	1,070	1,115	1,164	1,215	1,266	1,317	1,372	1,432	1,494	1,559	5,830	13,004
Corporate Income Taxes	274	351	402	439	459	458	450	450	455	463	475	487	2,208	4,539
Other														
Excise taxes	84	91	96	98	102	105	107	108	111	114	117	120	507	1,076
Federal Reserve remittances	76	93	89	56	14	8	21	30	36	42	45	51	188	391
Customs duties	32	33	36	38	41	43	45	47	50	53	57	60	202	469
Estate and gift taxes	19	19	20	23	25	26	27	28	29	31	32	33	120	273
Miscellaneous fees and fines	26	27	49	65	75	66	69	72	74	77	80	82	323	708
Subtotal	236	263	290	280	256	246	268	285	300	316	330	347	1,340	2,919
Total	2,774	3,029	3,305	3,481	3,631	3,770	3,932	4,104	4,288	4,490	4,702	4,926	18,120	40,630
On-budget	2,101	2,285	2,534	2,676	2,789	2,890	3,015	3,149	3,295	3,456	3,627	3,807	13,904	31,238
Off-budget ^a	673	743	771	805	842	880	918	955	994	1,034	1,076	1,119	4,215	9,392
Memorandum:														
Gross Domestic Product	16,627	17,273	18,126	19,083	20,052	20,954	21,867	22,799	23,755	24,746	25,774	26,830	100,082	223,984
As a Percentage of Gross Domestic Product														
Individual Income Taxes	7.9	8.0	8.5	8.6	8.7	8.8	8.9	9.0	9.1	9.2	9.3	9.4	8.7	9.0
Social Insurance Taxes	5.7	6.0	5.9	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8	5.8
Corporate Income Taxes	1.6	2.0	2.2	2.3	2.3	2.2	2.1	2.0	1.9	1.9	1.8	1.8	2.2	2.0
Other														
Excise taxes	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.5	0.4	0.5	0.5
Federal Reserve remittances	0.5	0.5	0.5	0.3	0.1	*	0.1	0.1	0.1	0.1	0.2	0.2	0.2	0.2
Customs duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Estate and gift taxes	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1
Miscellaneous fees and fines	0.2	0.2	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Subtotal	1.4	1.5	1.6	1.5	1.3	1.2	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Total	16.7	17.5	18.2	18.2	18.1	18.0	18.0	18.0	18.1	18.1	18.2	18.4	18.1	18.1
On-budget	12.6	13.2	14.0	14.0	13.9	13.8	13.8	13.8	13.9	14.0	14.1	14.2	13.9	13.9
Off-budget ^a	4.0	4.3	4.3	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2	4.2

Source: Congressional Budget Office.

Note: * = between zero and 0.05 percent.

a. Receipts from Social Security payroll taxes.

Individual Income Taxes

If current laws do not change, individual income taxes are expected to rise markedly relative to GDP over the next 10 years, as a result of structural features of the tax system (such as real bracket creep), recent changes in tax provisions, the ongoing economic recovery, and other factors. CBO projects that individual income tax receipts will increase as a percentage of GDP from 7.9 percent in 2013 to 8.5 percent in 2015; they will then rise by about

0.1 percentage point per year, reaching 9.4 percent of GDP in 2024 (see Table 4-1).

Significant Growth in Receipts Relative to GDP From 2013 to 2015

After declining by 23 percent between 2007 and 2010, receipts from individual income taxes grew in each of the past three years. They continue to grow in CBO's baseline projections—by 5 percent in 2014 and by 12 percent

in 2015. They are projected to total over \$1.5 trillion, or 8.5 percent of GDP; in 2015, the highest percentage since 2001 and also greater than the 40-year average of 7.9 percent.

Part of the projected increase in individual income tax receipts in 2014 and 2015 results from projected growth in taxable personal income, as measured in the national income and product accounts (NIPAs) produced by the Bureau of Economic Analysis. That measure of income includes wages, salaries, dividends, interest, rental income, and proprietors' income; its expected growth this year and next roughly corresponds to expected growth in GDP. However, several factors cause receipts from individual income taxes in CBO's baseline to rise relative to both taxable personal income and GDP—boosting revenues relative to GDP by 0.6 percentage points from 2013 to 2015. Those factors include growth in taxable income that is *not* included in the NIPAs, real bracket creep, and recent changes in tax provisions.

Increases in Certain Kinds of Taxable Income. The most significant increase in taxable income not included in the NIPAs consists of taxable distributions from tax-deferred retirement accounts, such as individual retirement accounts and 401(k) plans. Those distributions are projected to rise quickly in 2014 and 2015 because higher asset values, resulting especially from the rapid increase in equity prices over the past two years, have enlarged the balances in retirement accounts, allowing retirees to make larger withdrawals. The expected increase in distributions from retirement accounts raises CBO's projections of revenues as a percentage of GDP by 0.2 percentage points between 2013 and 2015.

Capital gains realizations are likewise not included in income in the national income and product accounts. CBO projects that, excluding the effects of tax law changes (which are considered separately and discussed below), capital gains realizations will increase from 2013 to 2015 as the economy continues to recover. That increase will raise revenues as a share of GDP over the two-year period by about 0.1 percentage point, CBO estimates.

Real Bracket Creep. CBO expects that average tax rates—that is, total taxes as a percentage of total income—will increase this year and in 2015 for a few reasons. The most significant of those reasons is real bracket creep. That phenomenon occurs because the income tax brackets and exemptions under both the regular income tax and the

alternative minimum tax (AMT) are indexed only to inflation.² When real economic growth occurs, total income grows faster than the inflation-indexed tax brackets do, pushing more income into higher tax brackets. That factor causes projected revenues as a share of GDP to rise by between 0.1 and 0.2 percentage points during the 2013–2015 period.

Changes in Tax Provisions. Average tax rates will also increase this year and next because of recent changes in tax law. The American Taxpayer Relief Act of 2012 (Public Law 112-240), which was enacted in early January 2013, permanently extended some lower tax rates and other tax provisions that had expired at the end of calendar year 2012 and limited the reach of the AMT. Nonetheless, some high-income taxpayers started to face higher tax rates—including rates applicable to ordinary income, capital gains, and dividends—at the beginning of 2013. In addition, 2013 saw the beginning of a surtax (enacted in the Affordable Care Act) of 3.8 percent on certain types of investment income for taxpayers with income over \$200,000 (for single filers) or \$250,000 (for joint filers).

Those higher tax rates were in effect for only three quarters of fiscal year 2013 (which began in October 2012), but they will be in effect for all four quarters of fiscal year 2014, boosting receipts in that year relative to receipts in 2013. However, the boost in 2014 will be smaller than it might have been, CBO estimates, because taxpayers responded to the higher tax rates by shifting some income—especially capital gains realizations—from calendar year 2013 to 2012. That shift raised receipts in fiscal year 2013, when taxpayers filed their tax returns for calendar year 2012, but will reduce receipts in fiscal year 2014, according to CBO's projections.

In addition, certain other tax provisions that reduced tax revenues expired at the end of 2013, including many provisions that were extended routinely in previous years (sometimes retroactively). Most notably, rules allowing accelerated depreciation deductions for certain business investments expired at the end of last year. That expiration does not affect corporations alone; it also affects noncorporate businesses, whose owners' income is subject

2. The alternative minimum tax is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. Households must calculate the amount that they owe under both the alternative minimum tax and the regular income tax, and then pay the larger of the two amounts.

to the individual income tax. The expiration will therefore increase individual income tax liabilities starting in calendar year 2014—liabilities that mostly will be paid by taxpayers starting in fiscal year 2015, CBO estimates.

Offsetting some of the revenue increases that will result from changes in tax provisions, new tax credits for individuals' purchases of health insurance through exchanges have gone into effect this year. CBO estimates that those tax credits will reduce revenues by \$2 billion in 2014 and by \$6 billion in 2015.³ On balance, however, the changes in tax provisions will cause individual income tax receipts as a share of GDP to increase by about 0.2 percentage points from 2013 to 2015.

Slower but Steady Growth in Receipts Relative to GDP After 2015

CBO projects that under current law, individual income tax receipts will rise from \$1.5 trillion in 2015 to \$2.5 trillion in 2024, for an average annual increase of about 6 percent; that would represent an increase of 0.9 percentage points of GDP, from 8.5 percent to 9.4 percent. Real bracket creep and growing distributions from tax-deferred retirement accounts will cause most of that increase.

Real Bracket Creep. Real bracket creep will raise individual income tax receipts as a share of GDP by about 0.5 percentage points between 2015 and 2024, CBO projects.

Distributions From Tax-Deferred Retirement Accounts. In coming years, as the population ages, taxable distributions from tax-deferred retirement accounts are expected to grow more rapidly than GDP. By CBO's estimate, the taxation of distributions from such accounts will cause revenues as a share of GDP to rise by about 0.2 percentage points from 2015 through 2024.

Other Factors. Other factors are expected to raise individual income tax receipts as a share of GDP by about 0.2 percentage points between 2015 and 2024. Wages and salaries—which have fallen sharply relative to GDP

since 2008—are expected to increase as a percentage of GDP (for more details, see Chapter 2). In addition, the wages and salaries of higher-income taxpayers are projected to grow faster than those of other taxpayers, increasing total taxes as a percentage of total income.

Social Insurance Taxes

From fiscal year 2012 to fiscal year 2013, receipts from payroll taxes, which fund social insurance programs, increased by about 12 percent—to 5.7 percent of GDP—primarily because of the expiration of a 2 percentage-point reduction in employees' share of the Social Security tax that was in effect during calendar years 2011 and 2012. Under current law, CBO projects, social insurance tax receipts will increase further as a percentage of GDP this year, to 6.0 percent, largely because this is the first full fiscal year after the tax rate reduction expired. Thereafter, social insurance tax receipts are projected to decline slightly as a percentage of GDP under current law—in 2015, to 5.9 percent, and in 2016, to 5.8 percent, where they are expected to remain through 2024.

Sources of Social Insurance Tax Receipts

By far the largest sources of social insurance tax receipts are payroll taxes for Social Security and payroll taxes for Part A of Medicare (the Hospital Insurance program). Much smaller sources are payroll taxes for unemployment insurance (whose revenues are classified as federal, even though most of the taxes are imposed by states); employers' and employees' contributions to the Railroad Retirement system, which functions for railroad employees the way Social Security does for most workers; and contributions to other federal retirement programs, mainly those made by federal employees (see Table 4-2). The premiums that Medicare enrollees pay for Part B (the Medical Insurance program) and Part D (prescription drug coverage) are voluntary payments and thus are not counted as tax revenues; rather, they appear on the spending side of the budget as offsetting receipts.

Social Security and Medicare payroll taxes are calculated as percentages of a worker's earnings. The Social Security tax is 12.4 percent of earnings, half paid by the employer and half by the employee. It does not apply to annual earnings above a certain amount, called the taxable maximum (currently \$117,000); that amount is indexed to grow over time at the same pace as average earnings for all workers. The Medicare tax is 2.9 percent of earnings for

3. Those tax credits are refundable, which means that any portion that exceeds an individual's tax liability is paid to that person and recorded in the budget not as a reduction in revenues but as an outlay. In this case, an additional \$13 billion in 2014 and \$33 billion in 2015 will be recorded in the budget as outlays, CBO estimates.

Table 4-2.**Social Insurance Tax Revenues Projected in CBO's Baseline**

(Billions of dollars)

	Actual,												Total	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-2019	2015-2024
Social Security	673	743	771	805	842	880	918	955	994	1,034	1,076	1,119	4,215	9,392
Medicare	209	227	238	251	264	278	291	304	318	333	349	365	1,321	2,991
Unemployment Insurance	57	54	52	49	48	47	47	46	48	51	55	59	243	502
Railroad Retirement	5	5	5	5	5	6	6	6	6	6	7	7	27	60
Other Retirement ^a	4	4	4	4	5	5	5	6	7	7	8	8	23	59
Total	948	1,033	1,070	1,115	1,164	1,215	1,266	1,317	1,372	1,432	1,494	1,559	5,830	13,004

Source: Congressional Budget Office.

a. Consists primarily of federal employees' contributions to the Federal Employees Retirement System and the Civil Service Retirement System.

most workers, with the employer and employee each paying half. In contrast with the Social Security tax, there is no taxable maximum for the Medicare tax. Moreover, since 2013, an additional Medicare tax of 0.9 percent, paid entirely by the employee, has been levied on an individual's earnings over \$200,000 (or on joint filers' total earnings over \$250,000), bringing the total Medicare tax for such people to 3.8 percent.

Slight Decline in Projected Receipts Relative to GDP

Relative to GDP, social insurance tax receipts are projected to decline slightly from 2014 to 2016 for two reasons. First, a growing share of earnings is anticipated to be above Social Security's taxable maximum.⁴ Second, receipts from unemployment insurance taxes are expected to decline in dollar terms (and therefore as a share of GDP). Those receipts grew rapidly from 2009 to 2012, as states raised their tax rates and tax bases and also made payments to replenish unemployment insurance trust funds that had been depleted because of high unemployment and consequently high unemployment insurance benefits. As trust fund balances improved in 2013, those receipts fell, and CBO expects them to continue to fall to more typical levels in coming years.

The same two factors are projected to continue pushing down social insurance revenues relative to GDP between

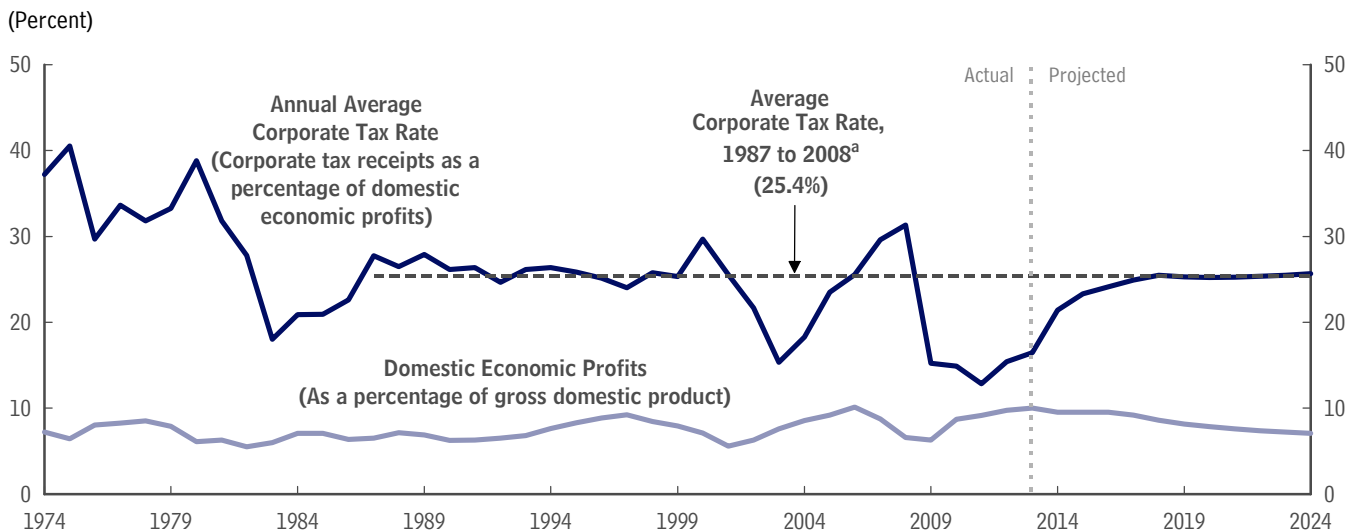
2016 and 2024—but they will be largely offset by other factors. The most important is that wages and salaries, the main component of the social insurance tax base, will increase as a share of GDP, CBO projects. Another factor boosting revenues from Medicare taxes relative to GDP is that, over time, a greater share of earnings will become subject to the additional 0.9 percent tax.

Corporate Income Taxes

In 2009, receipts from corporate income taxes fell to 1.0 percent of GDP, the lowest percentage in more than 70 years, as a result of a drop in taxable corporate profits during the recession and the government's policy responses to that economic downturn.⁵ Those receipts have rebounded to some extent since then—to 1.6 percent of GDP in 2013—but remain below the 40-year average of 1.9 percent. Under current law, CBO expects corporate income tax receipts to rise sharply relative to GDP during the next few years because of a continuing increase in the average corporate tax rate (that is, receipts as a percentage of domestic economic profits), the result of expiring tax provisions and other factors. In CBO's baseline, corporate income tax receipts reach 2.3 percent of GDP in 2016 and then decline gradually as a percentage of GDP, reaching roughly the historical average after 2020.

4. However, because of the progressive rate structure of the individual income tax, the increase in the share of earnings above the Social Security taxable maximum is projected to produce an increase in individual income tax receipts that will more than offset the decrease in social insurance tax receipts.

5. In particular, the American Recovery and Reinvestment Act of 2009 (P.L. 111-5) contained a number of provisions that temporarily reduced corporate income taxes.

Figure 4-3.**Average Corporate Tax Rate and Corporations' Domestic Economic Profits**

Source: Congressional Budget Office.

Note: Domestic economic profits, as measured in the national income and product accounts, are the profits that U.S. and foreign corporations earn from current production activities carried out within the United States. They exclude certain income of U.S.-based multinational corporations that is derived from foreign sources, most of which does not generate corporate income tax receipts in the United States.

- a. The measure represents the average of the annual amounts from 1987 to 2008. CBO uses a comparison period that begins in 1987 because the Tax Reform Act of 1986 put in place corporate tax rates and a tax base that, though modified in some ways by later legislation, still closely resemble the rates and base scheduled to be in effect over the 2014–2024 period.

Sharp Increase in Receipts Relative to GDP From 2013 Through 2016

CBO expects domestic economic profits—an approximation of the base on which corporate income taxes are paid—to decline by about 1 percent from 2013 to 2014 and to remain fairly stable relative to GDP for the following two years. Nevertheless, receipts from corporate income taxes are expected to climb by almost 30 percent from 2013 to 2014—from 1.6 percent of GDP to 2.0 percent—and then to grow by an additional 25 percent over the following two years, to 2.3 percent of GDP in 2016. The reason for the apparent discrepancy is that the average corporate tax rate will increase, according to CBO's projections, to nearly the average rate seen over the period from 1987 to 2008 (see Figure 4-3).⁶ That increase occurs in CBO's projections both because certain revenue-reducing tax provisions expired at the end of 2013 and because other factors that have held down the

average corporate tax rate since the recession ended are expected to continue to wane.

Expiration of Tax Provisions. A number of tax provisions that had been holding down corporate tax receipts expired at the end of 2013; those expirations boost revenues as a share of GDP in CBO's baseline by about 0.3 percentage points between 2013 and 2016. The most significant of those provisions, accounting for about half of the total effect from expiring provisions, involves the rate at which firms that bought equipment could deduct its costs from their taxable income to reflect depreciation in the equipment's value. In 2013, companies with large amounts of investment could expense—that is, immediately deduct—50 percent of the cost of their investments in equipment.⁷ This year, under current law, tax depreciation has reverted to the rules generally in effect before

6. CBO uses a comparison period that begins in 1987 because the Tax Reform Act of 1986 (P.L. 99-514) put in place corporate tax rates and a tax base that, though modified in some ways by later legislation, still closely resemble the rates and base scheduled to be in effect over the 2014–2024 period.

7. By contrast, businesses with relatively small amounts of investment in new equipment were allowed to fully deduct those costs in the year in which the equipment was placed in service. That has been the case since 1982 and remains so today, although the maximum amount of such investments allowed to be deducted has changed over time.

Table 4-3.**Smaller Sources of Revenues Projected in CBO's Baseline**

(Billions of dollars)

	Actual,												Total	
	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2015-	2015-
Excise Taxes													190	381
Highway	35	37	37	38	38	38	38	38	38	38	38	38	190	381
Tobacco	16	16	15	15	15	15	15	14	14	14	14	13	75	145
Aviation	13	13	14	14	15	16	16	17	18	18	19	20	76	168
Alcohol	10	10	10	10	10	10	11	11	11	11	11	12	51	108
Health insurance providers	0	7	10	11	13	13	14	15	16	17	18	18	62	145
Other	10	9	9	9	10	12	13	13	14	15	17	19	53	130
Subtotal	84	91	96	98	102	105	107	108	111	114	117	120	507	1,076
Federal Reserve Remittances	76	93	89	56	14	8	21	30	36	42	45	51	188	391
Customs Duties	32	33	36	38	41	43	45	47	50	53	57	60	202	469
Estate and Gift Taxes	19	19	20	23	25	26	27	28	29	31	32	33	120	273
Miscellaneous Fees and Fines														
Universal Service Fund fees	10	10	10	10	10	10	10	11	11	11	11	11	50	105
Other fees and fines	16	17	39	55	65	55	59	61	63	66	69	71	273	603
Subtotal	26	27	49	65	75	66	69	72	74	77	80	82	323	708
Total	236	263	290	280	256	246	268	285	300	316	330	347	1,340	2,919

Source: Congressional Budget Office.

Note: This table shows all projected sources of revenues other than individual and corporate income taxes and social insurance taxes.

2008, which usually require businesses to deduct their equipment investments over a number of years. Other recently expired provisions include tax credits for research and experimentation and tax incentives for certain types of foreign-earned income, both of which had been in effect for many years.

Other Factors Boosting Receipts. The average corporate tax rate fell sharply during the recession. The main factors behind that decline, other than changes in tax law, were a sharp drop in capital gains realizations by corporations and a sharp increase in deductions of bad debts from corporate income. Since the recession ended, the average corporate tax rate has recovered only partially and remains very low by historical standards. The sources of that slow recovery will not be known with certainty until information from tax returns becomes available in the future, but CBO expects that whatever factors have been at work will gradually dissipate as the economy continues to recover. The resulting higher average tax rate is projected to boost corporate receipts as a share of GDP by about 0.4 percentage points between 2013 and 2016.

Falling Receipts Relative to GDP After 2016

In CBO's baseline projections, corporate income tax receipts decline from 2.3 percent of GDP in 2016 to 1.8 percent in 2024. That decrease is attributable mainly to a projected drop in corporations' domestic economic profits as a share of GDP—from 9.2 percent in 2017 to 7.1 percent in 2024—which is expected to result primarily from rising interest payments on businesses' debt, growing labor costs, and increasing depreciation deductions on a growing stock of business capital. In CBO's projections, those factors are offset only slightly by a continued increase in the average corporate tax rate to about its historical average.

Smaller Sources of Revenues

The remaining sources of federal revenues are excise taxes, remittances from the Federal Reserve System, customs duties, estate and gift taxes, and miscellaneous fees and fines. Revenues from those sources totaled \$236 billion in 2013, or 1.4 percent of GDP (see Table 4-3). CBO's baseline projection shows such revenues increasing to \$263 billion in 2014, or 1.5 percent of GDP, and ranging

between 1.2 percent and 1.6 percent of GDP over the period from 2015 to 2024. The types of revenues that are projected to change the most from their current amounts are miscellaneous fees and fines (which increase, mostly because of new fees and fines enacted in the Affordable Care Act) and remittances from the Federal Reserve System (which decline over the next several years, as the size of the Federal Reserve's portfolio and its earnings return to a more typical relationship to GDP).

Excise Taxes

Unlike taxes on income, excise taxes are levied on the production or purchase of a particular type of good or service. Almost 90 percent of excise tax receipts over the coming decade will come from taxes related to highways, tobacco and alcohol, aviation, and health insurance. Receipts from excise taxes are expected to decrease slightly as a share of GDP over the next decade, from 0.5 percent in 2015 to 0.4 percent in 2024, largely because of declines in gasoline and tobacco taxes.

Highway Taxes. More than 40 percent of excise tax receipts come from highway taxes, primarily taxes on the consumption of gasoline, diesel fuel, and blends of those fuels with ethanol, as well as on the retail sale of trucks. Annual receipts from highway taxes, which are largely dedicated to the Highway Trust Fund, are projected to stay at \$37 billion or \$38 billion between 2014 and 2024 and to fall as a percentage of GDP.

That pattern is the net effect of falling receipts from taxes on gasoline and rising receipts from taxes on diesel fuel and trucks. Gasoline consumption is expected to decline because improvements in vehicles' fuel economy (resulting largely from increases in the government's fuel economy standards) will probably more than offset increases in the number of miles that people drive. Increasing fuel economy will likewise reduce the consumption of diesel fuel per mile driven—but not by enough, according to CBO's projections, to offset an increase in the total number of miles driven by diesel-powered trucks as the economy continues to expand.

Under current law, most of the federal excise taxes used to fund highways are scheduled to expire on September 30, 2016. In general, CBO's baseline incorporates the assumption that expiring tax provisions will follow the schedules set forth in current law. However, the Balanced Budget and Emergency Deficit Control Act of 1985 (P.L. 99-177) specifies that CBO's baseline should

incorporate the assumption that expiring excise taxes dedicated to trust funds (including most of the highway taxes) will be extended.

Tobacco and Alcohol Taxes. Taxes on tobacco products will generate \$16 billion in revenues in 2014, CBO projects. That amount is expected to decrease by 1 percent to 2 percent a year over the next decade, as the decline in tobacco consumption that has been occurring for many years continues. By contrast, receipts from taxes on alcoholic beverages, which are expected to total \$10 billion in 2014, are projected to rise at an average rate of almost 2 percent a year through 2024, the result of expected increases in alcohol consumption.

Aviation Taxes. CBO projects that receipts from taxes on airline tickets, aviation fuels, and various aviation-related transactions will increase from \$13 billion in 2014 to \$20 billion in 2024, yielding an average annual rate of growth of about 4 percent. That growth is close to the projected increase of GDP over that period, in part because the largest component of aviation excise taxes (a passenger ticket tax) is levied not on the number of units transacted (as gasoline taxes are, for example) but as a percentage of the dollar value of transactions—which causes receipts to increase as real economic activity and prices increase. Under current law, most aviation-related taxes are scheduled to expire on September 30, 2015, but CBO's baseline projections are required to incorporate the assumption that they, like the highway taxes described above, will be extended.

Tax on Health Insurance Providers. Under the Affordable Care Act, health insurers are subject to a new excise tax starting this year. The law specifies the total amount of tax to be assessed, and that total will be divided among insurers according to their share of total premiums charged. However, several categories of health insurers (such as self-insured plans, federal and state governments, and tax-exempt providers) are fully or partially exempt from the tax. Revenues from the tax are projected to total \$7 billion in 2014 and rise to \$18 billion by 2024.

Other Excise Taxes. Other excise taxes are projected to generate a total of about \$9 billion in revenues this year and \$130 billion in revenues between 2015 and 2024. About three-quarters of that \$130 billion stems from three charges instituted by the Affordable Care Act, each of which is estimated to yield excise tax revenue of about \$31 billion over the 2015–2024 period: an annual fee

charged on manufacturers and importers of brand-name drugs; a 2.3 percent tax on manufacturers and importers of certain medical devices; and a tax, beginning in 2018, on certain high-cost employment-based health insurance plans.⁸

Remittances From the Federal Reserve System

The income produced by the various activities of the Federal Reserve System, minus the cost of generating that income and the cost of the system's operations, is remitted to the Treasury and counted as revenues. The largest component of such income is what the Federal Reserve earns as interest on its holdings of securities. Over the past six years, the central bank has more than quadrupled the size of its asset holdings through significant purchases of Treasury securities and mortgage-backed securities issued by Fannie Mae, Freddie Mac, and the Government National Mortgage Association (Ginnie Mae). Those purchases raised remittances from the Federal Reserve from 0.2 percent of GDP in 2009 to about 0.5 percent of GDP between 2010 and 2013; the remittances totaled \$76 billion in 2013. CBO expects those remittances to increase in 2014 and 2015 to roughly \$90 billion per year (still about 0.5 percent of GDP) as a result of further increases in the size of the Federal Reserve's portfolio.

Beyond 2015, CBO expects remittances from the Federal Reserve to decline sharply, falling to less than 0.1 percent of GDP between 2017 and 2019. That drop largely reflects a projected increase in the rate at which the Federal Reserve pays interest to the financial institutions that hold deposits on reserve with it, which would increase the central bank's interest expense. Higher interest rates would also boost earnings for the Federal Reserve—but much more slowly, because the Federal Reserve would only gradually purchase new securities earning the higher yields.

After 2019, CBO anticipates, the size and composition of the Federal Reserve's portfolio, along with its remittances to the Treasury, will gradually return to amounts roughly in line with historical experience. According to CBO's projections, remittances over the 2022–2024 period will

average about 0.2 percent of GDP, roughly what they averaged from 2000 through 2009.

Customs Duties

Customs duties, which are assessed on certain imports, have totaled about 0.2 percent of GDP in recent years, amounting to \$32 billion in 2013. CBO projects that under current law, those receipts will continue at that level relative to GDP throughout the next decade.

Estate and Gift Taxes

Receipts from estate and gift taxes totaled about 0.1 percent of GDP in 2012 and 2013 (amounting to \$14 billion and \$19 billion, respectively), and CBO projects that under current law, those receipts will remain at about 0.1 percent of GDP from 2014 to 2024. That projection reflects provisions of the American Taxpayer Relief Act of 2012, which permanently extended most estate and gift tax provisions in place in 2012 (including the effective exemption amount, equal to \$5.34 million in 2014 and indexed annually for inflation) but raised the top marginal tax rate by 5 percentage points (to 40 percent).

Miscellaneous Fees and Fines

Miscellaneous fees and fines totaled \$26 billion in 2013 (or just under 0.2 percent of GDP) and will total \$27 billion in 2014 under current law, CBO projects. After 2014, those receipts will rise substantially (again, under current law), mainly because of provisions of the Affordable Care Act. The receipts in that category include penalties on employers that do not provide health insurance and fees paid to the government as part of the risk adjustment process for insurers under that act; according to that process, health insurance plans whose enrollees are expected to have below-average health care costs are required to make payments to the government, which distributes those sums to plans whose enrollees are expected to have above-average health care costs.⁹ After 2014, miscellaneous fees and fines will total about 0.3 percent of GDP, according to CBO's projections.

Tax Expenditures

A number of exclusions, deductions, preferential rates, and credits in the individual income tax, social insurance

8. The excise tax on high-cost health plans also increases CBO's projections of revenues from individual income and payroll taxes, because firms are expected to respond to the tax by shifting to lower-cost insurance plans—thereby reducing nontaxable labor compensation and increasing taxable compensation.

9. Miscellaneous receipts related to the Affordable Care Act also include collections for the reinsurance and risk corridor programs, which will expire after 2016 and generate receipts through 2017. See Appendix B for further details.

tax, and corporate income tax systems cause revenues to be much lower than they would be otherwise for any given structure of tax rates. Some of those provisions are called tax expenditures because they resemble federal spending by providing financial assistance to particular activities, entities, or groups of people.

Tax expenditures, like traditional forms of federal spending, contribute to the federal budget deficit; influence how people work, save, and invest; and affect the distribution of income. The Congressional Budget and Impoundment Control Act of 1974 defines tax expenditures as “those revenue losses attributable to provisions of the Federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability.”¹⁰ That law requires that a list of tax expenditures be included in the federal budget, and each year the Treasury’s Office of Tax Analysis and the staff of the Congress’s Joint Committee on Taxation publish estimates of individual and corporate income tax expenditures.¹¹

Tax expenditures are more similar to the largest benefit programs than to discretionary spending programs: They are not subject to annual appropriations, and any person or entity that meets the legal requirements can receive the benefits. Because of their budgetary treatment, however, tax expenditures are much less transparent than spending on benefit programs.

The Magnitude of Tax Expenditures

Tax expenditures have a major impact on the federal budget. On the basis of the estimates prepared by JCT, CBO projects that the more than 200 tax expenditures in the individual and corporate income tax systems will total roughly \$1.4 trillion in fiscal year 2014—or 8.2 percent of GDP—if their effects on social insurance taxes as well

as on income taxes are included.¹² That amount equals nearly half of all federal revenues projected for 2014 and exceeds projected spending on Social Security, defense, or Medicare (see Figure 4-4).

However, the total amount of tax expenditures does not represent the increase in revenues that would occur if all tax expenditures were eliminated, because repealing a tax expenditure would change incentives and lead taxpayers to modify their behavior in ways that would mute the revenue impact of the repeal. For example, if preferential tax rates on capital gains realizations were eliminated, taxpayers would reduce the amount of capital gains they realized; as a result, the amount of additional revenues that would be produced by eliminating the preferential rates would be smaller than the estimated size of the tax expenditure.

Furthermore, a simple total of the estimated revenue effects of repealing various tax expenditures would not account for the interactions that would arise if multiple expenditures were repealed at the same time. For instance, the effect of eliminating all itemized deductions would be smaller than the sum of the effects of eliminating each deduction, because with all of the deductions gone, more taxpayers would claim the standard deduction (instead of itemizing deductions) than would be the case if any single deduction was repealed. However, the structure of tax brackets and marginal rates ensures that the opposite would be the case with income exclusions; that is, the effect of eliminating all exclusions would be greater than the sum of the effects of eliminating each separate exclusion. As it turns out, however, the effect in fiscal year 2014 of eliminating *all* individual income tax expenditures would be roughly equal to the sum of the effects of eliminating each of those tax expenditures.

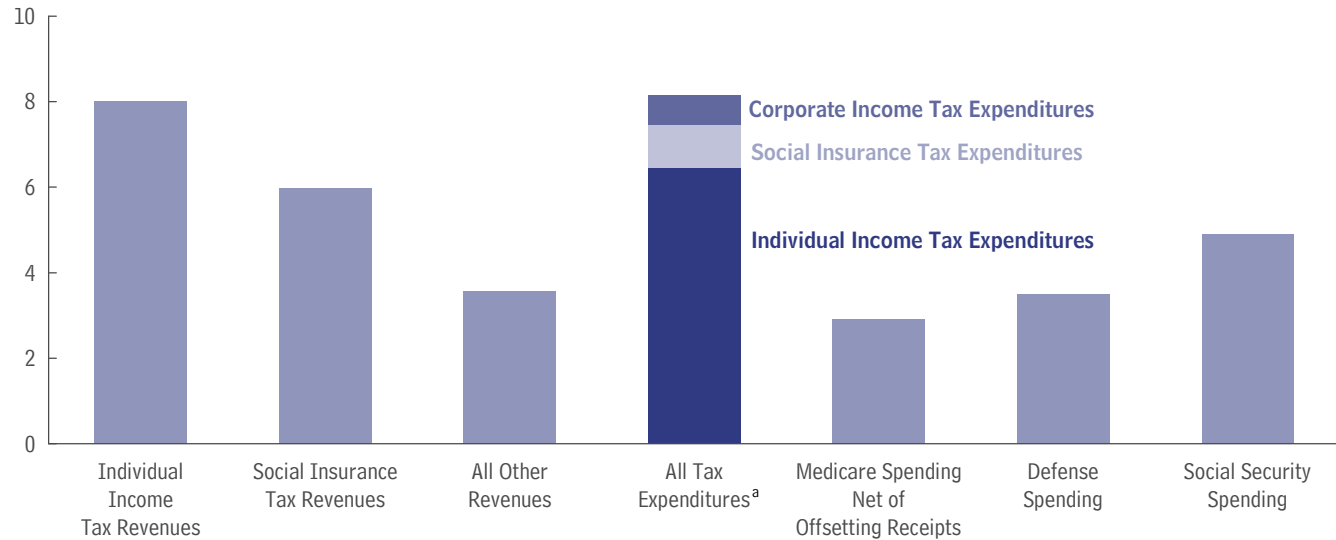
10. Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974, P.L. 93-344 (codified at 2 U.S.C. §622(3) (2006)).

11. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), <http://go.usa.gov/ZHCz>; and Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2014: Analytical Perspectives* (April 2013), pp. 241–277, <http://go.usa.gov/BC4Q>.

12. Most estimates of tax expenditures include only their effects on individual and corporate income taxes. However, tax expenditures can also reduce the amount of income subject to payroll taxes. JCT has previously estimated the effect on payroll taxes of the provision that excludes employers’ contributions for health insurance premiums from their workers’ taxable income. See Joint Committee on Taxation, *Background Materials for Senate Committee on Finance Roundtable on Health Care Financing*, JCX-27-09 (May 8, 2009), <http://go.usa.gov/ZJcx>. Tax expenditures that reduce the tax base for payroll taxes will eventually decrease spending for Social Security by reducing the wage base on which Social Security benefits are calculated.

Figure 4-4.**Revenues, Tax Expenditures, and Selected Components of Spending in 2014**

(Percentage of gross domestic product)



Source: Congressional Budget Office based on estimates by the staff of the Joint Committee on Taxation.

- a. This total is the sum of the estimates for all of the separate tax expenditures and does not account for any interactions among them. However, CBO estimates that in 2014, the effect of eliminating all tax expenditures would be roughly equal to the sum of the effects of eliminating each of the tax expenditures separately. Because estimates of tax expenditures are based on people's behavior with the tax expenditures in place, the estimates do not reflect the amount of revenue that would be raised if those provisions of the tax code were eliminated and taxpayers adjusted their activities in response to the changes.

Economic and Distributional Effects of Tax Expenditures

Tax expenditures are generally designed to further societal goals. For example, the tax expenditures for health insurance costs, pension contributions, and mortgage interest payments may help to promote a healthier population, adequate financial resources for retirement and greater national saving, and stable communities of homeowners. However, tax expenditures have a broad range of effects that may not always further societal goals. They may lead to an inefficient allocation of economic resources by encouraging more consumption of goods and services receiving preferential treatment; they may also subsidize activity that would have taken place without the tax incentives. Moreover, by providing benefits to particular activities, entities, or groups of people, tax expenditures increase the size and scope of federal involvement in the economy. Tax expenditures also reduce the amount of revenue that is collected for any given set of statutory tax rates—and therefore require higher rates to collect any chosen amount of revenue. All else being equal, those

higher tax rates lessen people's incentives to work and save, decreasing output and income.

Tax expenditures are distributed unevenly across the income scale. When measured in dollars, tax expenditures benefit higher-income households much more than lower-income households. As a percentage of people's income, tax expenditures benefit the highest-income and lowest-income households to a greater extent than they benefit households in the middle of the income distribution.¹³

The Largest Tax Expenditures

CBO estimates that the 12 largest tax expenditures will account for almost three-quarters of the total budgetary effects of all tax expenditures in fiscal year 2014 and will total about 6.5 percent of GDP over the period from

13. For a detailed analysis of the distribution of tax expenditures, see Congressional Budget Office, *The Distribution of Major Tax Expenditures in the Individual Income Tax System* (May 2013), www.cbo.gov/publication/43768.

2015 to 2024.¹⁴ Those 12 tax expenditures fall into four categories: exclusions from taxable income, itemized deductions, preferential tax rates, and tax credits.

Exclusions From Taxable Income. Exclusions from taxable income account for the greatest share of total tax expenditures. The largest items in that category are employers' contributions for their employees' health care, health insurance premiums, and long-term-care insurance premiums; contributions to and earnings of pension funds (minus pension benefits that are included in taxable income); Medicare benefits (net of premiums paid); profits earned abroad, which certain corporations may exclude from their taxable income until those profits are returned to the United States; and capital gains from assets that are transferred at the owner's death.

The exclusion of employers' health insurance contributions is the single largest tax expenditure in the individual income tax code; including effects on payroll taxes, it is projected to equal 1.6 percent of GDP over the 2015–2024 period (see Figure 4-5). The exclusion of pension contributions and earnings has the next-largest impact, generating net tax expenditures, including effects on payroll taxes, estimated to total 0.9 percent of GDP over the same period.¹⁵ The tax expenditures for the exclusion of Medicare benefits, for the deferral of corporate profits earned abroad, and for unrealized capital gains at death

are projected to equal about 0.5 percent, 0.3 percent, and 0.3 percent of GDP over the coming decade, respectively.

Itemized Deductions. Itemized deductions for spending on certain items allow taxpayers to further reduce their taxable income. The tax expenditures for deductions for state and local taxes (on nonbusiness income, sales, real estate, and personal property) and for interest paid on mortgages for owner-occupied residences are each projected to equal about 0.5 percent of GDP between 2015 and 2024. The tax expenditures for deductions for charitable contributions are projected to equal 0.3 percent of GDP over that period.

Preferential Tax Rates. Under the individual income tax, preferential tax rates apply to some forms of income, including dividends and long-term capital gains.¹⁶ Tax expenditures for the preferential tax rates on dividends and long-term capital gains are projected to total 0.6 percent of GDP between 2015 and 2024.¹⁷

Tax Credits. Tax credits reduce eligible taxpayers' tax liability. Nonrefundable tax credits cannot reduce a taxpayer's income tax liability below zero; refundable tax credits, by contrast, may provide direct payments to taxpayers who do not owe any income taxes. Beginning in 2014, the Affordable Care Act provides refundable tax credits, called premium assistance credits, to help low- and moderate-income people purchase health insurance through exchanges (see Appendix B). Because CBO and JCT project that participation in exchanges will increase considerably during the next few years, the tax

14. Those 12 tax expenditures are the ones whose budgetary effects, according to JCT's estimates, will equal more than 0.25 percent of GDP over the 2014–2017 period. CBO combined the components of certain tax expenditures that JCT reported separately, such as tax expenditures for different types of charitable contributions. CBO also extrapolated JCT's estimates for the 2012–2017 period through 2024. (Those extrapolated estimates would not precisely match estimates produced by JCT.) JCT defines tax expenditures as deviations from an individual income tax structure that incorporates the existing regular tax rates, standard deduction, personal exemptions, and deduction of business expenses. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2012–2017*, JCS-1-13 (February 1, 2013), <http://go.usa.gov/ZHCz>.

15. That total includes amounts from defined benefit and defined contribution plans offered by employers; it does not include amounts from self-directed individual retirement arrangements or from Keogh plans that cover partners and sole proprietors, though contributions to and earnings in those plans are also excluded from taxable income.

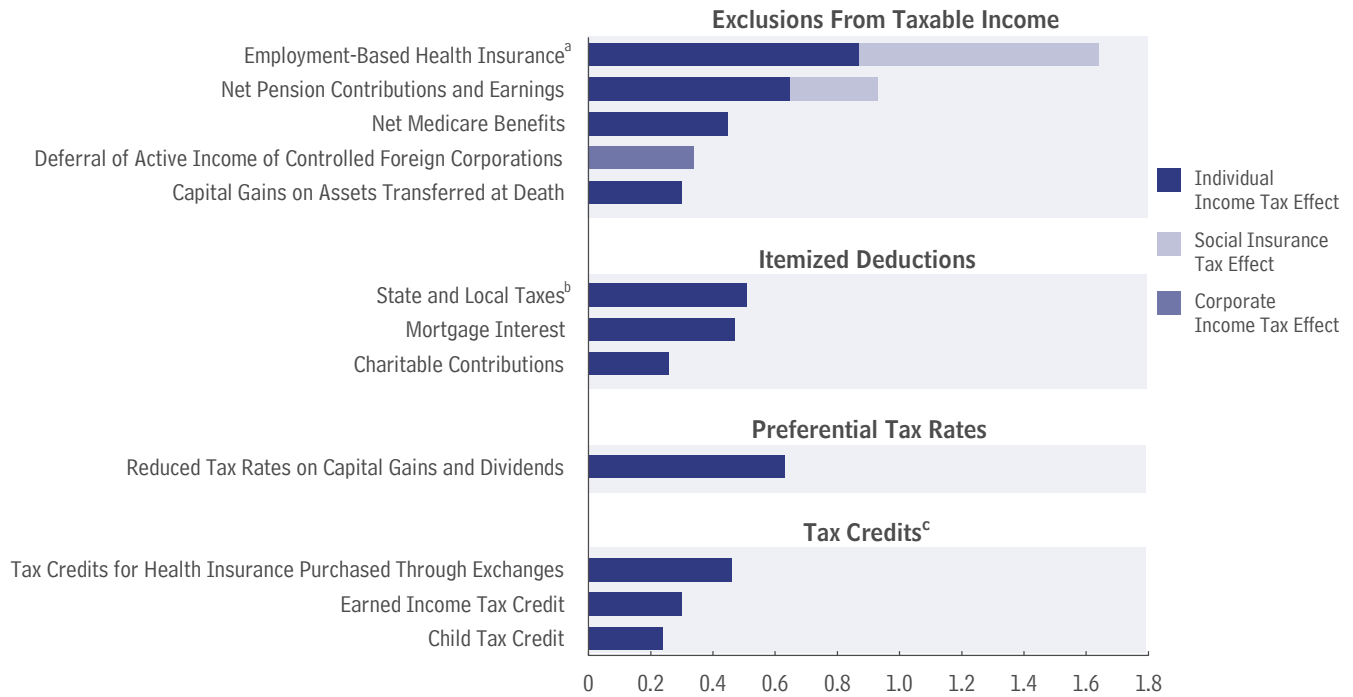
16. Not all analysts agree that those lower tax rates on investment income constitute tax expenditures. Although those tax preferences would be tax expenditures relative to a pure income tax, they would not be relative to a pure consumption tax, because investment income generally would be excluded from taxation under a consumption tax.

17. Taxpayers with income over certain thresholds—\$200,000 for single filers and \$250,000 for joint filers—face a surtax equal to 3.8 percent of their investment income (including capital gains and dividend income, as well as interest income and some passive business income). That surtax effectively reduces the preferential tax rate on dividends and capital gains. JCT treats the surtax as a *negative* tax expenditure—that is, a deviation from the tax system that increases rather than decreases taxes—and it is not included in the figures presented here.

Figure 4-5.

Budgetary Effects of the Largest Tax Expenditures From 2015 to 2024

(Percentage of gross domestic product)



Source: Congressional Budget Office based in part on estimates by the staff of the Joint Committee on Taxation.

Note: These effects are calculated as the sum of the tax expenditures over the 2015–2024 period divided by the sum of gross domestic product over the same 10 years. Because estimates of tax expenditures are based on people’s behavior with the tax expenditures in place, the estimates do not reflect the amount of revenue that would be raised if those provisions of the tax code were eliminated and taxpayers adjusted their activities in response to the changes.

- a. Includes employers’ contributions for health care, health insurance premiums, and long-term-care insurance premiums.
- b. Consists of nonbusiness income, sales, real estate, and personal property taxes paid to state and local governments.
- c. Includes effect on outlays.

expenditure for premium assistance credits (including the refundable portion) is projected to grow from 0.2 percent of GDP in 2015 to 0.5 percent of GDP in 2017, where it is expected to remain from 2018 through 2024. The next-largest refundable credits are the earned income tax credit (for which tax expenditures, including the refundable portion, are projected to be 0.3 percent of GDP between 2015 and 2024) and the child tax credit

(0.2 percent of GDP over the same period, also including the refundable portion). Both of those credits were significantly expanded in 2001 and again in later years, but the expansions enacted since 2008 are scheduled to expire at the end of December 2017; thus, under current law, the budgetary effect of those two credits will decline modestly in the future.

