CHAPTER

4

The Revenue Outlook

The Congressional Budget Office projects that revenues will edge up from 17.5 percent of gross domestic product (GDP) in fiscal year 2014 to 17.7 percent in 2015, slightly above the 50-year average of 17.4 percent (see Figure 4-1). In 2016, CBO projects, if current laws generally do not change, federal revenues will rise significantly—to 18.4 percent of GDP—because of the expiration of certain provisions of law that reduce tax liabilities. After that, revenues as a share of GDP are projected to fall slightly and then remain relatively stable, near 18 percent of GDP, through 2025.

In 2015, federal revenues will total about $3.2 trillion, CBO estimates—$168 billion, or 5.6 percent, more than the amount collected in 2014. That increase, at a faster pace than GDP, stems largely from an anticipated rise in individual income tax receipts—up from 8.1 percent of GDP in 2014 to 8.3 percent this year, in part because of an increase in average tax rates (total taxes as a percentage of total income). As the economy grows, people's incomes rise faster than tax brackets increase because tax brackets are indexed only to inflation; that phenomenon is known as real bracket creep. In addition, CBO expects an increase in distributions from tax-deferred retirement accounts whose balances have been boosted in the past few years by strong stock market gains.

CBO projects that revenues will rise more rapidly in 2016, by 8.5 percent. Most of that increase results from the expiration, at the end of calendar year 2014, of several provisions that reduced the income tax liabilities of corporations and individuals—including one provision that allowed businesses to immediately deduct significant portions of their investments in equipment. Those provisions have been extended routinely in the past for limited periods, but CBO's baseline follows current law. Under current law, the expiration of those provisions will boost corporate and individual income tax payments somewhat in fiscal year 2015 but much more in 2016 and later years because payments in 2015 will still reflect much of the effects of those provisions before expiration.

In CBO's baseline projections, revenues remain between 18.0 percent and 18.3 percent of GDP from 2017 through 2025, largely because of offsetting movements in three sources of revenue:

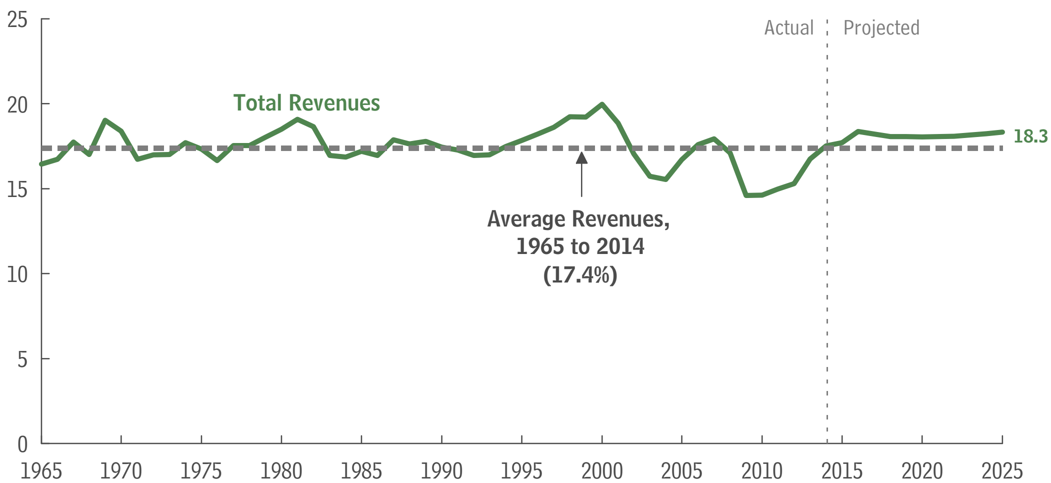
- Individual income tax receipts, which are projected to increase relative to GDP, mostly as a result of rising average tax rates from real bracket creep;
- Corporate income tax receipts, which are projected to decline relative to GDP, largely because of an expected drop in domestic economic profits relative to the size of the economy, the result of growing labor costs and rising interest payments on businesses' debt; and
- Remittances to the U.S. Treasury from the Federal Reserve System, which have been very large since 2010 because of substantial changes in the size and composition of the central bank's portfolio but which are projected to decline to more typical amounts relative to GDP.

CBO's projections of revenues for the 2015–2024 period are slightly below those it published in August 2014. At that time, CBO published revenue projections for the period from 2014 to 2024; the projections in this report cover the 2015–2025 period. For the overlapping years—2015 through 2024—the current projections are below the previous ones by $415 billion (or 1.0 percent), and they are lower in every year except 2016. Those revisions reflect the downward revision to CBO's forecast of GDP growth, the recent one-year extension of expired tax provisions, and other factors. (For more information on changes since August to the revenue projections, see Appendix A.)

Figure 4-1.

Total Revenues

Percentage of Gross Domestic Product



Under current law, revenues will rise as a share of GDP in 2016 because of several expired tax provisions but then level off.

Source: Congressional Budget Office.

The tax rules that form the basis of CBO's projections include an array of exclusions, deductions, preferential rates, and credits that 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 with the largest effects 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 deductions for state and local taxes (on nonbusiness income, sales, real estate, and personal property).

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 almost $1.5 trillion in 2015—an amount equal to 8.1 percent of GDP, or equivalent to nearly half of the revenues projected for the year.[1] Most of that amount arises from the 11 largest tax expenditures, which CBO estimates will total 5.9 percent of GDP in 2015 and 6.6 percent of GDP from 2016 to 2025.

The Evolving Composition of Revenues

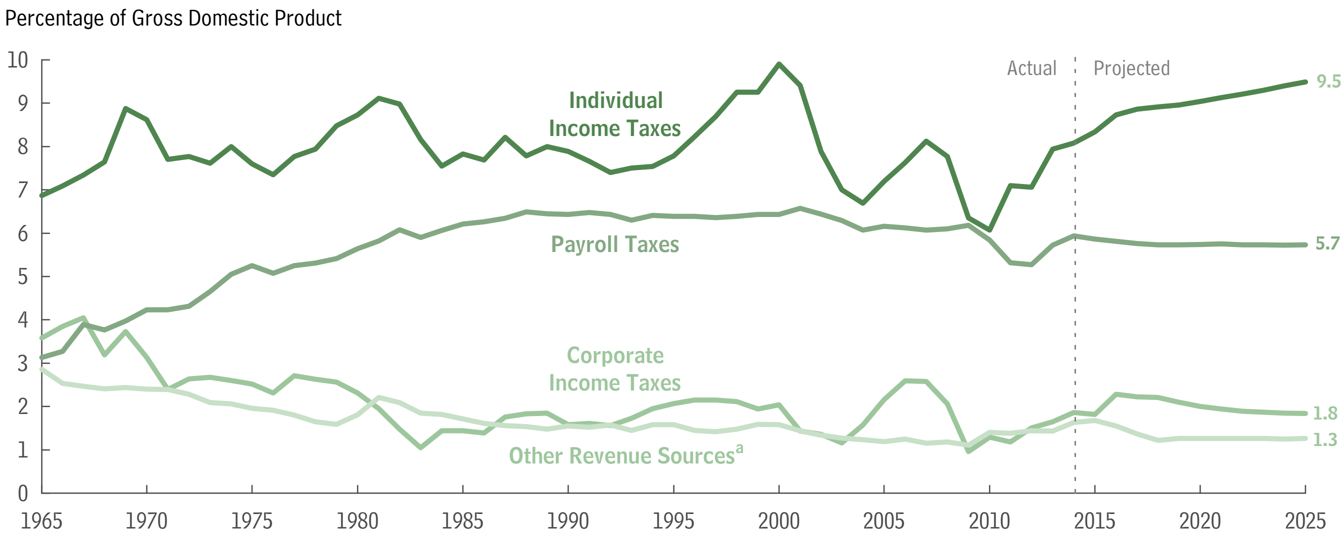
Federal revenues come from various sources: individual income taxes; payroll taxes, which are dedicated to certain social insurance programs; corporate income taxes; excise taxes; earnings of the Federal Reserve System, which are remitted to the Treasury; customs duties; estate and gift taxes; and miscellaneous fees and fines. Individual income taxes constitute the largest source of federal revenues, having contributed, on average, about 45 percent of total revenues (equal to 7.9 percent of GDP) over the past 50 years. Payroll taxes—mainly for Social Security and Medicare Part A (the Hospital Insurance program)—are the second-largest source of revenues, averaging about one-third of total revenues (equal to 5.7 percent of GDP) over the same period. Corporate income taxes contributed 12 percent of revenues (or 2.1 percent of GDP) over

1. See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2014–2018,* JCX-97-14 (August 2014), http://go.usa.gov/zDb5. CBO used its economic forecast to extrapolate the estimates beyond 2018 and included projected effects on payroll taxes.

Figure 4-2.

Revenues, by Major Source

Over the next decade, individual income taxes will grow at a faster rate than other taxes primarily because of "real bracket creep," which occurs when income grows faster than inflation and more income is pushed into higher tax brackets.



Source: Congressional Budget Office.

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

the past 50 years, and all other sources combined contributed about 10 percent of revenues (or 1.7 percent of GDP).

Although that broad picture has remained roughly the same over the past several decades, the details have varied:

- Receipts from individual income taxes have fluctuated more than the other major types of revenues, ranging from 41 percent to 50 percent of total revenues (and from 6.1 percent to 9.9 percent of GDP) between 1965 and 2014, but showing no clear trend over that period (see Figure 4-2).

- Receipts from payroll taxes rose as a share of revenues from the mid-1960s through the 1980s—largely because of an expansion of payroll taxes to finance the new Medicare program and because of legislated increases in payroll tax rates for Social Security and in the amount of income to which those taxes applied. Those receipts reached about 37 percent of total revenues (and about 6.5 percent of GDP) by the late 1980s. Since 2001, payroll tax receipts have fallen slightly relative to GDP, accounting for 6.0 percent of the economy, on average; over the period from 2001 to 2014. Those receipts were unusually low in 2011 and 2012 because of a two-year cut in the employees' share of the Social Security payroll tax.

- Revenues from corporate income taxes declined as a share of total revenues and GDP from the 1960s to the mid-1980s, mainly because of declining profits relative to the size of the economy. Those revenues have fluctuated widely since then, with no particular trend.

- Revenues from the remaining sources together have slowly fallen relative to total revenues and GDP, largely because of declining receipts from excise taxes. However, that downward trend has reversed in the past several years because of the increase in remittances from the Federal Reserve System.

Under current law, CBO projects, individual income taxes will generate a growing share of revenues over the next decade. By 2020, they will account for more than half of total revenues, and by 2025, they will reach 9.5 percent of GDP, well above the historical average. Receipts from payroll taxes are projected to decline slightly relative to GDP, from 5.9 percent in 2014 to

5.7 percent for the period from 2018 to 2025. Corporate income taxes are expected to make roughly the same contribution that they have made on average for the past 50 years, supplying just over 10 percent of total revenues and averaging about 2 percent of GDP. Taken together, the remaining sources of revenue are expected to diminish somewhat relative to total revenues and GDP, largely because of a decline in Federal Reserve remittances to more typical amounts; those sources are projected to average a bit more than 1 percent of GDP from 2018 through 2025.

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, the result of structural features of the tax system (such as real bracket creep), recent changes in tax provisions, and other factors. CBO projects that individual income tax receipts will increase from 8.1 percent of GDP in 2014 to 8.7 percent in 2016; they will then rise by about 0.1 percentage point of GDP per year, on average, through 2025 (see Table 4-1).

Significant Growth in Receipts Relative to GDP From 2014 to 2016

After declining by 23 percent between 2007 and 2010, receipts from individual income taxes have risen in each of the past four years. That trend continues in CBO's projection, with such receipts increasing by 8 percent in 2015 and by 9 percent in 2016. In 2016 they are projected to total more than $1.6 trillion; at 8.7 percent of GDP, they will equal the highest percentage since 2001 and be well above the 50-year average of 7.9 percent of GDP.

Part of the projected increase in individual income tax receipts in 2015 and 2016 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 includes wages, salaries, dividends, interest, rental income, and proprietors' income; its expected growth in 2015 and 2016 of 4 percent to 4½ percent corresponds roughly to expected growth in nominal GDP. However, projected receipts from individual income taxes rise faster than projected taxable personal income—boosting receipts relative to GDP by 0.6 percentage points from 2014 to 2016—because of real bracket creep, recent changes in tax provisions, and other factors.

Real Bracket Creep. The most significant factor pushing up taxes relative to income 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] If incomes grow faster than inflation, as generally occurs when the economy is growing, more income is pushed into higher tax brackets. In CBO's estimates, real bracket creep raises revenues relative to GDP by 0.2 percentage points between 2014 and 2016.

Recent Changes in Tax Provisions. The Tax Increase Prevention Act of 2014 (Division A of Public Law 113-295), which was enacted in December 2014, retroactively extended many tax provisions that reduced tax liabilities and had been extended routinely in previous years. However, those provisions were extended only through December 2014. Their expiration generates a marked increase in tax revenues next year in CBO's current-law projections. The largest effect will come from the expiration of rules allowing certain businesses to immediately deduct a portion of their equipment investments. That expiration will increase receipts from both the corporate income tax and the individual income tax, because the rules apply both to C corporations, whose income is subject to the corporate tax, and to S corporations and noncorporate businesses, whose income is subject to the individual tax. Other significant expiring tax provisions included the option to deduct state and local sales taxes rather than income taxes and the ability to exclude forgiven mortgage debt from taxable income. If the expired provisions are not extended again, those expirations will increase individual income tax liabilities starting in calendar year 2015, thus affecting income tax payments starting in fiscal year 2016, by CBO's estimates.[3]

2. The AMT 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.

3. CBO estimates that the effect of higher tax liabilities on tax payments in fiscal year 2015 will be offset by refunds that will be owed to taxpayers as a result of the retroactive nature of the recent extension. Some individual taxpayers probably increased their estimated payments in 2014 because of the previous expiration of the provisions at the end of 2013; because of the retroactive extension, those taxpayers will receive refunds (or make smaller payments than otherwise) when they file their tax returns in 2015. Such refunds will probably be more significant for corporations, which are required to adjust their estimated payments more than individual taxpayers are in response to changes in expected tax liabilities.

Table 4-1.

Revenues Projected in CBO's Baseline

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
							In Billions of Dollars							
Individual Income Taxes	1,395	1,503	1,644	1,746	1,832	1,919	2,017	2,124	2,235	2,352	2,477	2,606	9,158	20,952
Payroll Taxes	1,024	1,056	1,095	1,136	1,179	1,227	1,281	1,337	1,391	1,449	1,508	1,573	5,917	13,175
Corporate Income Taxes	321	328	429	437	453	450	447	450	459	472	488	506	2,216	4,591
Other														
Excise taxes	93	96	98	102	105	107	108	111	113	115	117	119	520	1,094
Federal Reserve remittances	99	102	76	40	17	27	31	34	37	42	47	52	191	404
Customs duties	34	36	39	41	43	45	48	50	53	56	59	63	216	497
Estate and gift taxes	19	20	21	22	22	23	24	25	26	27	27	28	113	246
Miscellaneous fees and fines	36	48	57	63	63	67	69	73	76	78	81	82	320	710
Subtotal	282	302	292	269	251	269	280	293	305	318	330	345	1,361	2,952
Total	**3,021**	**3,189**	**3,460**	**3,588**	**3,715**	**3,865**	**4,025**	**4,204**	**4,389**	**4,591**	**4,804**	**5,029**	**18,652**	**41,670**
On-budget	2,285	2,426	2,667	2,763	2,858	2,974	3,099	3,242	3,389	3,550	3,722	3,906	14,362	32,171
Off-budget[a]	736	763	793	824	857	891	926	962	1,001	1,040	1,081	1,124	4,291	9,499
Memorandum:														
Gross Domestic Product	17,251	18,016	18,832	19,701	20,558	21,404	22,315	23,271	24,261	25,287	26,352	27,456	102,810	229,438
							As a Percentage of Gross Domestic Product							
Individual Income Taxes	8.1	8.3	8.7	8.9	8.9	9.0	9.0	9.1	9.2	9.3	9.4	9.5	8.9	9.1
Payroll Taxes	5.9	5.9	5.8	5.8	5.7	5.7	5.7	5.7	5.7	5.7	5.7	5.7	5.8	5.7
Corporate Income Taxes	1.9	1.8	2.3	2.2	2.2	2.1	2.0	1.9	1.9	1.9	1.9	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	0.4	0.4	0.5	0.5
Federal Reserve remittances	0.6	0.6	0.4	0.2	0.1	0.1	0.1	0.1	0.2	0.2	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	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Subtotal	1.6	1.7	1.5	1.4	1.2	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3	1.3
Total	**17.5**	**17.7**	**18.4**	**18.2**	**18.1**	**18.1**	**18.0**	**18.1**	**18.1**	**18.2**	**18.2**	**18.3**	**18.1**	**18.2**
On-budget	13.2	13.5	14.2	14.0	13.9	13.9	13.9	13.9	14.0	14.0	14.1	14.2	14.0	14.0
Off-budget[a]	4.3	4.2	4.2	4.2	4.2	4.2	4.1	4.1	4.1	4.1	4.1	4.1	4.2	4.1

Source: Congressional Budget Office.

a. Receipts from Social Security payroll taxes.

Including other recently enacted legislation—which will have smaller effects—CBO estimates that changes in tax provisions will generate little net change in revenues in 2015 and will boost revenues relative to GDP by about 0.2 percentage points in 2016.

Other Factors. CBO anticipates that individual income tax revenues will also increase relative to GDP this year and next for a number of other reasons. The most significant one is that taxable distributions from tax-deferred retirement accounts, such as individual retirement accounts and 401(k) plans, are estimated to have risen substantially in 2014 and are expected to do so again in 2015 and 2016. Those larger projected distributions are the result of an increase in asset values (mainly because of rising equity prices over the past few years) that has raised the balances in people's retirement accounts. That factor and others are expected to boost revenues relative to GDP by about 0.3 percentage points between 2014 and 2016.

Table 4-2.

Payroll Tax Revenues Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Social Security	736	763	793	824	857	891	926	962	1,001	1,040	1,081	1,124	4,291	9,499
Medicare	224	234	245	258	270	282	295	309	323	338	354	370	1,351	3,045
Unemployment Insurance	55	51	48	44	42	44	50	55	56	58	60	65	229	523
Railroad Retirement	5	5	5	5	5	5	5	6	6	6	6	7	26	56
Other Retirement[a]	3	4	4	4	4	4	5	5	6	6	7	7	21	52
Total	**1,024**	**1,056**	**1,095**	**1,136**	**1,179**	**1,227**	**1,281**	**1,337**	**1,391**	**1,449**	**1,508**	**1,573**	**5,917**	**13,175**

Source: Congressional Budget Office.

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

Steady Growth in Receipts Relative to GDP After 2016

CBO projects that, under current law, individual income tax receipts will rise from about $1.6 trillion in 2016 to about $2.6 trillion in 2025, for an average annual increase of roughly 5 percent; as a result, those receipts will climb from 8.7 percent of GDP in 2016 to 9.5 percent in 2025. Real bracket creep and several other factors will generate that increase, CBO projects.

Real Bracket Creep. Real bracket creep will raise individual income tax receipts relative to GDP by 0.4 percentage points between 2016 and 2025, CBO projects. That increase accounts for just over half of the total increase in individual income tax receipts as a percentage of GDP for the period.

Other Factors. CBO anticipates that individual income tax receipts will rise relative to GDP by 0.3 percentage points between 2016 and 2025 for other reasons. As the population ages, for example, taxable distributions from tax-deferred retirement accounts will tend to grow more rapidly than GDP. Earnings also are expected to grow faster for higher-income people than for others during the next decade—as they have for the past several decades—causing a larger share of income to be taxed at higher income tax rates. Furthermore, total earnings are projected to rise slightly relative to GDP from 2016 to 2025, reflecting a small increase in the labor share of national income (see Chapter 2 for a more detailed discussion).

Payroll Taxes

Receipts from payroll taxes, which fund social insurance programs, totaled about $1.0 trillion in 2014, or 5.9 percent of GDP. Under current law, CBO projects, those receipts will fall to 5.7 percent of GDP by 2018 and then roughly stabilize relative to GDP through 2025.

Sources of Payroll Tax Receipts

The two largest sources of payroll tax receipts are the taxes that are dedicated to Social Security and Part A of Medicare. Much smaller amounts are collected in the form of unemployment insurance taxes (most imposed by states but classified as federal revenues); employers' and employees' contributions to the Railroad Retirement System; and other contributions to 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 benefits) are voluntary and thus are not counted as tax revenues; rather, they are considered offsets to spending and appear on the spending side of the budget as offsetting receipts.

Payroll taxes for Social Security and Medicare are calculated as percentages of people's earnings. The Social Security tax is usually 12.4 percent of earnings, with the employer and employee each paying half. The tax applies only up to a certain amount of a worker's annual earnings (called the taxable maximum, currently $118,500) that is indexed to grow over time at the same pace as average earnings for all workers. The Medicare tax applies to all earnings (with no taxable maximum) and is levied at a rate of 2.9 percent, with the employer and employee each paying half. Starting in 2013, an additional Medicare tax of 0.9 percent has been assessed on the amount of an individual's earnings over $200,000 (or $250,000 for married couples filing joint income tax returns), bringing the total Medicare tax on such earnings to 3.8 percent.

Slight Decline in Projected Receipts Relative to GDP

Although wages and salaries, the main tax bases for payroll taxes, are projected to be fairly stable relative to GDP over the next several years, CBO estimates that payroll tax receipts will decline slightly relative to GDP through 2018 for two main reasons. First, payroll taxes are expected to decrease relative to wages and salaries—and hence GDP—because a growing share of earnings is anticipated to be above the taxable maximum amount for Social Security taxes.[4] Second, between 2014 and 2018, receipts from unemployment insurance taxes are projected to decline relative to wages and salaries. Those receipts grew rapidly from 2010 through 2012 as states raised their tax rates and tax bases to replenish unemployment insurance trust funds that had been depleted because of high unemployment; CBO expects unemployment insurance receipts to fall to more typical levels in the coming years.

For the rest of the projection period, from 2019 to 2025, CBO projects that offsetting factors will cause payroll tax receipts to be roughly stable relative to GDP. The share of earnings above the taxable maximum for Social Security taxes is expected to continue to increase, lowering payroll tax revenues relative to wages and salaries. However, that effect is largely offset by small projected increases in wages and salaries as a share of GDP.

Corporate Income Taxes

In 2014, receipts from corporate income taxes totaled $321 billion, or 1.9 percent of GDP—near the 50-year average. CBO expects corporate tax receipts to rise a little in nominal terms in 2015 and then to increase sharply in 2016 because of the expiration of several tax provisions. As a result, estimated receipts fall slightly as a share of GDP in 2015 and then jump to 2.3 percent of GDP in 2016. Thereafter through 2025, CBO projects, those receipts will fall relative to GDP—down to 1.8 percent—largely because profits are projected to decline relative to GDP.

Little Growth in Receipts in 2015

CBO expects income tax payments by corporations, net of refunds, to increase by about 2 percent this year, to $328 billion, even though the agency projects that domestic economic profits will grow by 8.5 percent. Because revenue growth is projected to rise at less than half the pace of GDP growth, projected revenues as a share of GDP decline slightly to 1.8 percent.

That projected slow growth in corporate income tax receipts results mostly from the retroactive one-year extension—enacted in December 2014 in the Tax Increase Prevention Act of 2014—of various provisions that reduce tax liabilities. The largest revenue impact will stem from the extension of rules that allowed businesses with large amounts of investment to expense—that is, to immediately deduct—50 percent of their investments in equipment.[5]

Because the more favorable rules for investment deductions and other tax-reducing provisions were not initially extended when they expired at the end of calendar year 2013, many companies paid more in estimated taxes during calendar year 2014. Because those provisions were extended retroactively late in the year, those businesses will receive refunds or make smaller final payments when they file their 2014 tax returns in 2015. The effect will be to slow growth in receipts this year.

Sharp Increase in Receipts in 2016

Under current law, CBO projects, corporate income tax revenues will rise to $429 billion in 2016, an increase of roughly $100 billion, or 31 percent, from the amount projected for 2015. As a result, corporate income tax revenues are projected to climb from 1.8 percent of GDP in 2015 to 2.3 percent in 2016, which would be the highest percentage since 2007. Of that 0.5 percentage-point increase, 0.4 percentage points stems from the retroactively enacted extension of the more favorable rules for

4. Because the income tax has a progressive rate structure, 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 payroll tax receipts.

5. By contrast, since 1982 businesses with relatively small amounts of investment in new equipment have been allowed to fully deduct those costs in the year in which the equipment is placed in service. Although that provision remains in effect today, the maximum amount of those deductions has changed over time.

depreciation and other tax-reducing provisions. That one-year extension lowers projected receipts in 2015 but not in 2016, thereby boosting growth between those years.

Most of the remaining increase in corporate tax revenues relative to GDP in 2016 results from an expected reversion in the average tax rate on domestic economic profits—that is, corporate taxes divided by domestic economic profits as measured in the NIPAs—toward more typical levels. That measure of the average tax rate fell sharply during the latest recession because of a combination of a sharp drop in capital gains realizations by corporations, a sharp increase in deductions of bad debts from corporate income, and changes in tax law. Since the recession ended in June 2009, that measure has recovered only partially, and the reasons for the slow recovery in that measure will not be known with certainty until additional information from tax returns becomes available in the future. Nevertheless, CBO expects that whatever factors have been at work will gradually dissipate over the next few years, and the average tax rate will return closer to its prerecession level.

Decline in Receipts Relative to GDP After 2016

In CBO's projections, corporate income tax receipts fall from 2.3 percent of GDP in 2016 to 1.8 percent in 2025. That decline occurs mostly because of a concurrent drop projected for domestic economic profits—from 9.8 percent of GDP in 2016 to 7.8 percent in 2025—primarily because of increases in labor costs and interest payments on businesses' debt relative to GDP.

CBO incorporated three other factors into its projection of a decline in corporate tax revenue as a percentage of GDP after 2016. First is the above-noted expiration of more favorable rules for deducting the cost of investment in business equipment. Under those rules, deductions were larger when investments were first made and smaller thereafter. Under the less favorable rules in effect under current law for calendar year 2015 and subsequent years, deductions are smaller when investments are made and larger thereafter. Projected receipts in fiscal year 2016 (the first fiscal year that fully reflects the less favorable rules) thus are higher because of the smaller initial deductions for new investments. Over time, however, that effect diminishes as larger deductions are taken for investments made under the less favorable rules.

Another factor contributing to the projected decline in corporate tax revenues relative to GDP is a pair of strategies that CBO expects corporations will follow to reduce their tax liabilities. One strategy is to continue decreasing the share of business activity that occurs in C corporations (which are taxed under the corporate income tax) while increasing the share that occurs in pass-through entities such as S corporations (which are taxed under the individual income tax rather than the corporate tax).[6] Another strategy is to increase the amount of corporate income that is shifted out of the United States through a combination of more aggressive transfer-pricing methods and intercompany loans, additional corporate inversions, and other techniques.[7] CBO expects that increasing adoption of such strategies will result in progressively larger reductions in corporate receipts over the 2015–2025 projection period. By 2025, in CBO's baseline, corporate income tax receipts are roughly 5 percent lower than they would be without that further erosion of the corporate tax base; slightly more than half of that difference is attributable to the shifting of additional income out of the United States.

A final factor that partially offsets the effects of the others—pushing corporate tax revenue up as a percentage of GDP—is the agency's expectation that, by 2019, the average tax rate on domestic economic profits will be closer to its historical average.

Smaller Sources of Revenues

The remaining sources of federal revenues are excise taxes, remittances from the Federal Reserve System to the Treasury, customs duties, estate and gift taxes, and miscellaneous fees and fines. Revenues from those sources totaled $282 billion in 2014, or 1.6 percent of GDP (see Table 4-3). CBO's baseline projection shows such revenues increasing to $302 billion in 2015, or 1.7 percent of GDP, and then falling to 1.2 percent or 1.3 percent

6. For a detailed analysis of the taxation of business income through the individual income tax, see Congressional Budget Office, *Taxing Businesses Through the Individual Income Tax* (December 2012), www.cbo.gov/publication/43750.

7. Under a corporate inversion, a U.S. corporation can change its country of tax residence, often by merging with a foreign company. Inversions reduce U.S. corporate tax revenue both because the inverted U.S. corporation no longer must pay U.S. taxes on earnings in other countries and because a corporation can shift additional income out of the United States through the use of intercompany loans and the resulting interest expenses.

Table 4-3.

Smaller Sources of Revenues Projected in CBO's Baseline

Billions of Dollars

	Actual, 2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	Total 2016-2020	Total 2016-2025
Excise Taxes														
Highway	37	38	39	39	39	39	39	39	39	38	38	38	195	388
Tobacco	15	14	14	14	13	13	13	13	12	12	12	12	67	128
Aviation	13	14	15	15	16	16	17	18	18	19	20	20	78	173
Alcohol	10	10	10	10	11	11	11	11	11	11	12	12	53	110
Health insurance providers	7	11	11	13	14	15	15	16	17	18	19	20	68	159
Other	10	9	10	11	12	13	13	14	15	16	17	18	58	137
Subtotal	93	96	98	102	105	107	108	111	113	115	117	119	520	1,094
Federal Reserve Remittances	99	102	76	40	17	27	31	34	37	42	47	52	191	404
Customs Duties	34	36	39	41	43	45	48	50	53	56	59	63	216	497
Estate and Gift Taxes	19	20	21	22	22	23	24	25	26	27	27	28	113	246
Miscellaneous Fees and Fines														
Universal Service Fund fees	10	10	11	12	12	12	12	12	13	13	13	13	59	123
Other fees and fines	26	38	46	52	51	55	57	60	63	66	68	69	261	587
Subtotal	36	48	57	63	63	67	69	73	76	78	81	82	320	710
Total	**282**	**302**	**292**	**269**	**251**	**269**	**280**	**293**	**305**	**318**	**330**	**345**	**1,361**	**2,952**

Source: Congressional Budget Office.

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

of GDP each year from 2018 to 2025. The projected decline in those revenues relative to GDP stems largely from an expected drop in Federal Reserve remittances as the size and composition of the central bank's portfolio return to more typical conditions.

Excise Taxes

Unlike taxes on income, excise taxes are levied on the production or purchase of a particular type of good or service. Under the assumptions that govern CBO's baseline, almost 90 percent of excise tax receipts over the coming decade are projected to come from taxes related to highways, tobacco and alcohol, aviation, and health insurance. Receipts from excise taxes are expected to decrease slightly relative to GDP over the next decade, from 0.5 percent in 2015 to 0.4 percent in 2025. That decrease occurs largely because gasoline and tobacco taxes will decline in nominal dollars, which implies significant reductions relative to the size of the economy.

Highway Taxes. About 40 percent of excise tax receipts currently comes from highway taxes, primarily 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 $38 billion or $39 billion each year between 2015 and 2025 and therefore to shrink as a percentage of GDP.

That pattern is the net effect of generally declining receipts from taxes on gasoline and rising receipts from taxes on diesel fuel and trucks. CBO expects that gasoline consumption will decline over time, as improvements in vehicles' fuel economy resulting from tighter federal standards for fuel economy more than offset increases in the number of miles that people drive stemming from both population increases and real income gains per person. For 2015, however, the recent decline in gasoline prices will also boost miles driven, so CBO projects that gasoline use and tax revenues will be roughly in line with last year's figures; with prices of crude oil expected to rise again later this year, further price-induced increases in miles driven are not anticipated (see Box 2-2 on page 31).[8] Increasing fuel economy will likewise reduce the consumption of diesel fuel per miles driven—but not by enough over the next decade, according to CBO's projections, to offset an increase in the total number of miles driven in diesel-powered trucks.

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 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 $14 billion in revenues in 2015, CBO projects. That amount is expected to decrease by about 2 percent per year over the next decade, as the decline in tobacco use that has been occurring for many years continues. By contrast, receipts from taxes on alcoholic beverages, which are expected to total $10 billion in 2015, are projected to rise at an average rate of 1.5 percent a year through 2025, the result of expected increases in consumption.

Aviation Taxes. CBO projects that receipts from taxes on airline tickets, aviation fuels, and other aviation-related items will increase from $14 billion in 2015 to $20 billion in 2025, yielding an average annual rate of growth of about 4 percent. That growth is close to the projected increase of GDP over the 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 prices and real economic activity 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 (ACA), health insurers are subject to an excise tax. The amount is specified in law and must 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. CBO estimates that revenues from the tax totaled $7 billion in 2014 and will rise to $11 billion in 2015 and to $20 billion by 2025.

Other Excise Taxes. Other excise taxes are projected to generate $9 billion in revenues in 2015 and $137 billion over the next decade. Of that 10-year amount, $96 billion stems from three charges instituted by the ACA, each estimated to yield revenue of between $31 billion and $33 billion over the 2016–2025 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.[9]

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 seven years, the central bank has quintupled the size of its asset holdings through purchases of Treasury securities and mortgage-backed securities issued by Fannie Mae, Freddie Mac, and the Government National Mortgage Association (known as Ginnie Mae). Those purchases raised remittances of the Federal Reserve from $34 billion (0.2 percent of GDP) in 2008 to $99 billion (0.6 percent of GDP) in 2014.

CBO expects remittances to remain around $100 billion in 2015 and then to decline sharply in subsequent years, falling to $17 billion (less than 0.1 percent of GDP) in 2018. That drop largely reflects a projected increase in

8. The recent decline in gasoline prices also has shifted the composition of vehicle purchases toward vehicles with lower fuel economy. Despite that change, the new vehicles still have higher fuel economy than those they are replacing, so overall fuel economy continues to improve.

9. The excise tax on high-cost health insurance plans also increases the amounts CBO projects for revenues from individual income and payroll taxes because businesses are expected to respond to the tax by shifting to lower-cost insurance plans—thereby reducing nontaxable labor compensation and increasing taxable compensation.

the rate at which the Federal Reserve pays interest to the financial institutions that hold deposits on reserve with it, thus increasing its interest expenses. CBO also projects an increase in interest rates on Treasury securities in the next several years, which will boost earnings for the Federal Reserve—but only gradually as it purchases new securities earning higher yields. (See Chapter 2 for a discussion of CBO's forecasts of monetary policy and interest rates in the coming decade.)

After 2018, CBO anticipates, the size and composition of the Federal Reserve's portfolio, along with its remittances to the Treasury, will gradually return to conditions more in line with historical experience. According to CBO's projections, remittances over the 2022–2025 period will average 0.2 percent of GDP, roughly matching the 2000–2009 average.

Customs Duties, Estate and Gift Taxes, and Miscellaneous Fees and Fines

Customs duties, which are assessed on certain imports, have totaled 0.2 percent of GDP in recent years, amounting to $34 billion in 2014. CBO projects that, under current law, those receipts will continue at that level relative to GDP throughout the next decade.

Receipts from estate and gift taxes in 2014 totaled $19 billion, or 0.1 percent of GDP. CBO projects that, under current law, those receipts will remain at that same percentage of GDP through 2025.

Miscellaneous fees and fines totaled $36 billion in 2014 (0.2 percent of GDP) and under current law will total $48 billion in 2015 (0.3 percent of GDP), CBO projects. The increase stems largely from provisions of the ACA, including the risk-adjustment process for which collections and payments begin this year. Under risk adjustment, health insurance plans whose enrollees are expected to have below-average health care costs must make payments to the government, which will distribute those sums to plans whose enrollees are expected to have above-average health care costs.[10] Miscellaneous fees and fines will continue to average 0.3 percent of GDP from 2016 through 2025, CBO projects.

10. Miscellaneous receipts related to the ACA also include collections for the reinsurance program, which will expire after 2016 and generate receipts through 2017. See Appendix B for more information.

Tax Expenditures

Many exclusions, deductions, preferential rates, and credits in the individual income tax, payroll tax, and corporate income tax systems cause revenues to be much lower than they would otherwise be for any underlying structure of tax rates. Some of those provisions, called tax expenditures, resemble federal spending in that they provide financial assistance to particular activities, entities, or groups of people.

Like conventional federal spending, tax expenditures contribute to the federal budget deficit. They also influence people's choices about working, saving, and investing, and they 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."[11] That law requires the federal budget to list tax expenditures, and each year JCT and the Treasury's Office of Tax Analysis publish estimates of individual and corporate income tax expenditures.[12]

Tax expenditures are more similar to the largest benefit programs than they are to discretionary spending programs: Tax expenditures are not subject to annual appropriations, and any person or entity that meets the legal

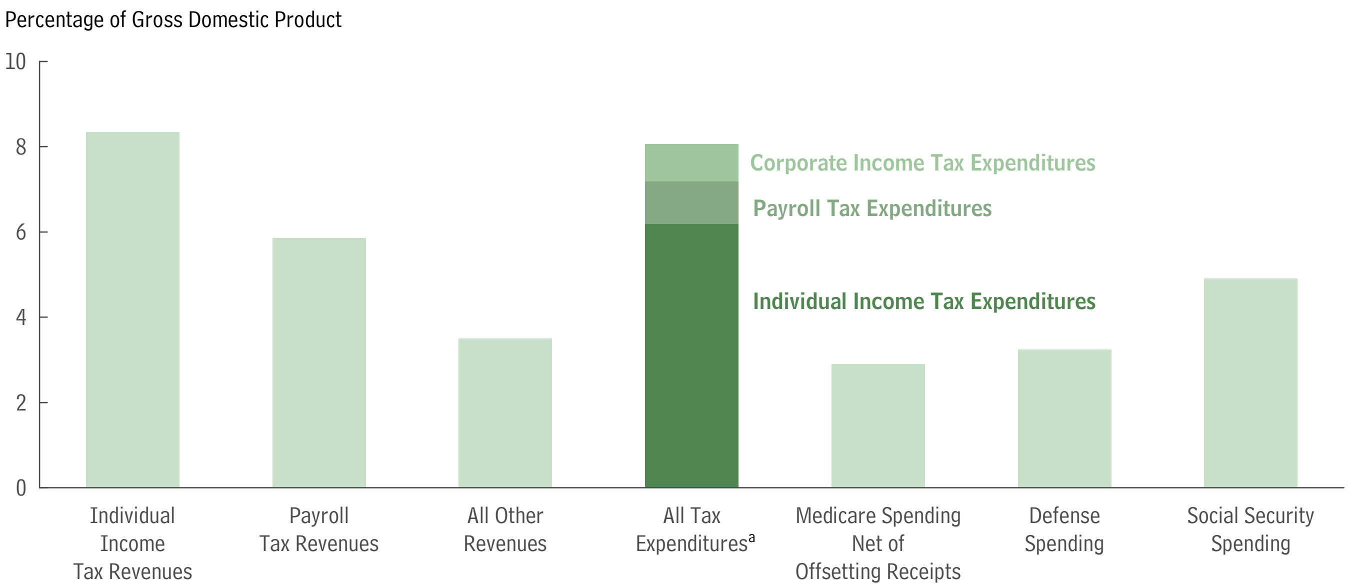
11. Section 3(3) of the Congressional Budget and Impoundment Control Act of 1974, P.L. 93-344 (codified at 2 U.S.C. §622(3) (2006)).

12. For this analysis, CBO follows JCT's definition of tax expenditures as deviations from a "normal" income tax structure. For the individual income tax, that structure incorporates existing regular tax rates, the standard deduction, personal exemptions, and deductions of business expenses. For the corporate income tax, that structure includes the top statutory tax rate, defines income on an accrual basis, and allows for cost recovery according to a specified depreciation system. For more information, see Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2014–2018*, JCX-97-14 (August 2014), http://go.usa.gov/zDb5. Unlike JCT, CBO includes estimates of the largest payroll tax expenditures. CBO defines a normal payroll tax structure to include the existing payroll tax rates as applied to a broad definition of compensation—which consists of cash wages and fringe benefits. The Office of Management and Budget's definition of tax expenditures is broadly similar to JCT's. See Office of Management and Budget, *Budget of the U.S. Government, Fiscal Year 2015: Analytical Perspectives* (March 2014), pp. 203–239, http://go.usa.gov/zNQ5.

Figure 4-3.

Revenues, Tax Expenditures, and Selected Components of Spending in 2015

Tax expenditures, projected to total $1.5 trillion in 2015, cause revenues to be lower than they would be otherwise and, like spending programs, contribute to the federal deficit.



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 2015, the total of all tax expenditures roughly equals the sum of each considered separately. Furthermore, 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.

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 $1.5 trillion in fiscal year 2015—or 8.1 percent of GDP—if their effects on payroll taxes as well as on income taxes are included.[13] That amount equals nearly half of all federal revenues projected for 2015 and exceeds projected spending on Social Security, defense, or Medicare (see Figure 4-3).

A simple total of the estimates for particular tax expenditures does not account for the interactions among them if they are considered together. For instance, the tax expenditure for all itemized deductions taken as a group is smaller than the sum of the separate tax expenditures for each deduction; the reason is that, if the entire group of deductions did not exist, more taxpayers would claim the standard deduction instead of itemizing deductions than would be the case if any single deduction did not exist. However, the structure of tax brackets and marginal rates ensures that the opposite would be the case with income exclusions; that is, the tax expenditure for all exclusions considered together would be greater than the sum of the separate tax expenditures for each exclusion. Currently, those and other factors are approximately offsetting, so

13. 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 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 earnings base on which Social Security benefits are calculated.

the total amount of tax expenditures roughly equals the sum of all of the individual tax expenditures.

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 diminish 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.

Economic and Distributional Effects of Tax Expenditures

Tax expenditures are generally designed to further societal goals. For example, those 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. But tax expenditures also 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 the goods and services that receive preferential treatment, and they may subsidize an activity that would have taken place even without the tax incentives. Moreover, by providing benefits to particular activities, entities, or groups of people, tax expenditures increase the extent 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 particular amount of revenue. All else being equal, those higher tax rates lessen people's incentives to work and save, thus decreasing output and income.

Tax expenditures are distributed unevenly across the income scale. When measured in dollars, much more of the tax expenditures go to higher-income households than to lower-income households. As a percentage of people's income, tax expenditures are greater for the highest-income and lowest-income households than for households in the middle of the income distribution.[14]

The Largest Tax Expenditures

CBO estimates that the 11 largest tax expenditures will account for almost three-quarters of the total budgetary effects of all tax expenditures in fiscal year 2015 and will total 6.6 percent of GDP over the period from 2016 to 2025.[15] Those 11 tax expenditures fall into four categories: exclusions from taxable income, itemized deductions, preferential tax rates, and tax credits.

Exclusions From Taxable Income. Exclusions of certain types of income from taxation 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); and profits earned abroad, which certain corporations may exclude from their taxable income until those profits are returned to the United States.

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 2016–2025 period (see Figure 4-4). The exclusion of pension contributions and earnings has the next-largest impact, resulting in tax expenditures, including effects on payroll taxes, estimated to total 1.1 percent of GDP over the same period.[16] Over the coming decade, the tax expenditures for the deferral of corporate profits earned abroad and for the exclusion of Medicare benefits are each projected to equal 0.4 percent of GDP.

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

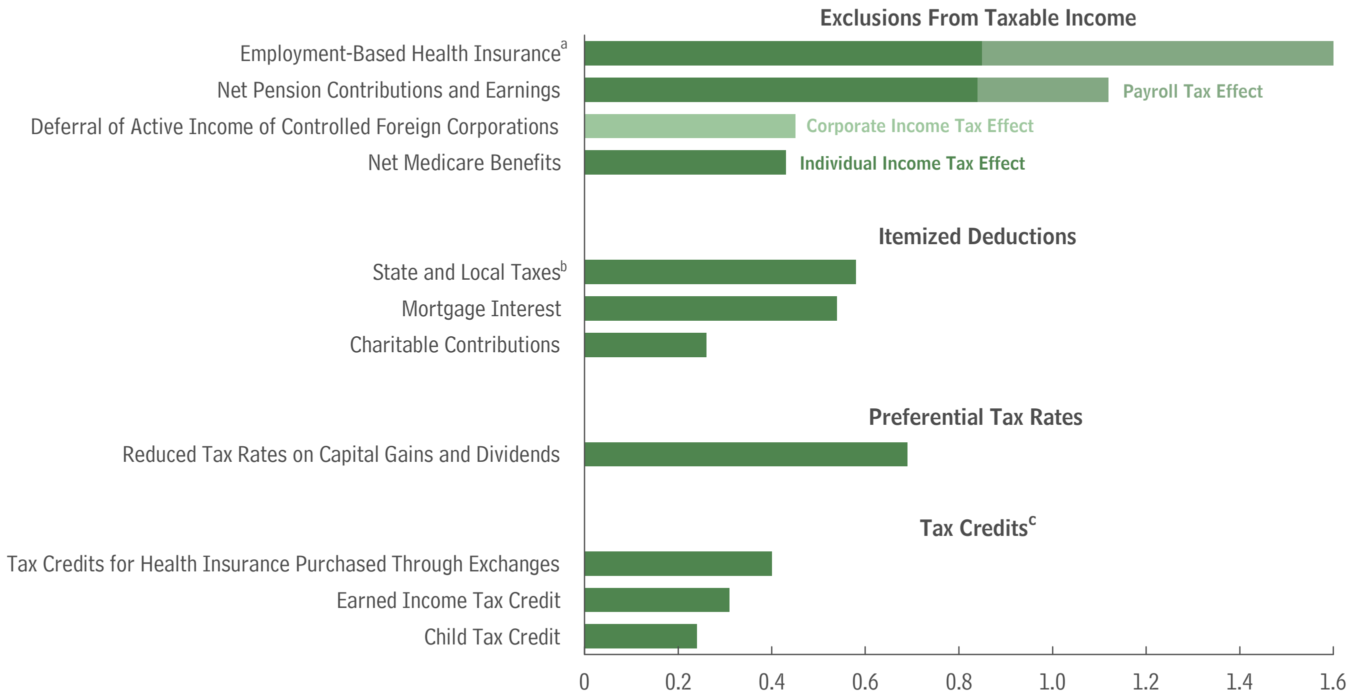
15. Those 11 tax expenditures are the ones whose budgetary effects, according to JCT's estimates, will equal more than 0.25 percent of GDP over the 2014–2018 period. CBO combined the components of certain tax expenditures that JCT reported separately, such as tax expenditures for different types of charitable contributions. CBO also extrapolated JCT's estimates for the 2014–2018 period through 2025. (Those extrapolated estimates would not precisely match estimates produced by JCT.) See Joint Committee on Taxation, *Estimates of Federal Tax Expenditures for Fiscal Years 2014–2018*, JCX-97-14 (August 2014), http://go.usa.gov/zDb5.

16. 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, although contributions to and earnings in those plans also are excluded from taxable income.

Figure 4-4.

Budgetary Effects of the Largest Tax Expenditures From 2016 to 2025

Percentage of Gross Domestic Product



Source: Congressional Budget Office based 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 2016–2025 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.

Itemized Deductions. Itemized deductions for certain types of payments 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) are projected to equal 0.6 percent of GDP between 2016 and 2025. Those for interest paid on mortgages for owner-occupied residences and for charitable contributions are projected to equal 0.5 percent and 0.3 percent of GDP respectively 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.[17] Tax expenditures for the preferential tax rates on dividends and long-term capital gains are projected to total 0.7 percent of GDP between 2016 and 2025.[18]

Tax Credits. Tax credits reduce eligible taxpayers' tax liability. Nonrefundable tax credits cannot reduce a

17. Not all analysts agree that those lower tax rates on investment income constitute tax expenditures. Although such tax preferences are tax expenditures relative to a pure income tax, which is the benchmark used by JCT and the Office of Management and Budget in calculating tax expenditures, they are not tax expenditures relative to a pure consumption tax, because investment income generally is excluded from taxation under a consumption tax.

18. Taxpayers with income over certain thresholds—$200,000 for single filers and $250,000 for married couples filing joint returns—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, as a deviation from the tax system that increases rather than decreases taxes—and it is not included in the figures presented here.

taxpayer's income tax liability to below zero, but refundable tax credits may provide direct payments to taxpayers who do not owe any income taxes.

The ACA provides refundable tax credits, called premium assistance credits, to help low- and moderate-income people purchase health insurance through exchanges (see Appendix B). Tax expenditures for those credits are projected to total 0.4 percent of GDP over the next decade.

The next-largest refundable credits are the earned income tax credit and the child tax credit. Both credits were significantly expanded in 2001 and again in later years, but 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 after that. Including the refundable portion, the tax expenditures for the earned income tax credit are projected to be 0.3 percent of GDP between 2016 and 2025. Tax expenditures for the child tax credit, again including the refundable portion, are projected to be 0.2 percent of GDP over the same period.