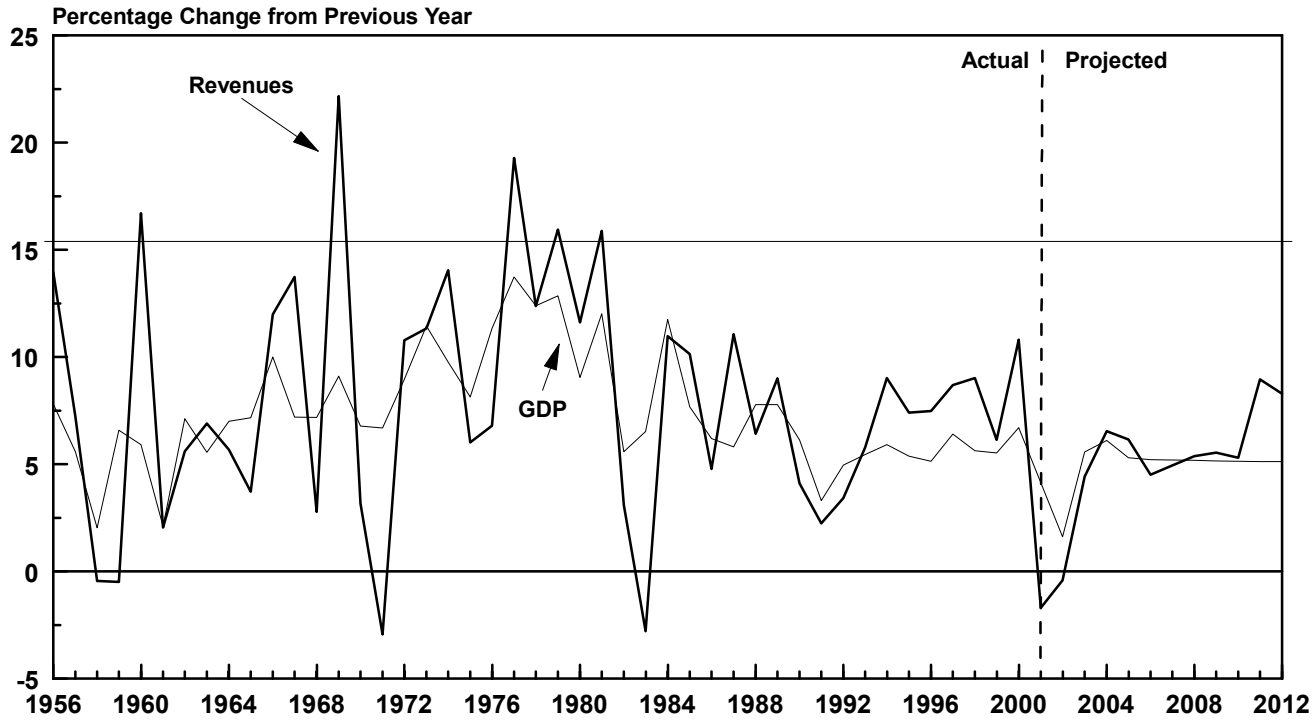
Chapter Three

The Revenue Outlook

The Congressional Budget Office estimates that if current policies remain unchanged, federal revenues will total about $1,980 billion in fiscal year 2002. That level of tax receipts would be close to $10 billion less than total revenues in 2001 and roughly $40 billion less than overall receipts in 2000—and would represent the first time since 1959 that revenues had dropped for two years in a row.

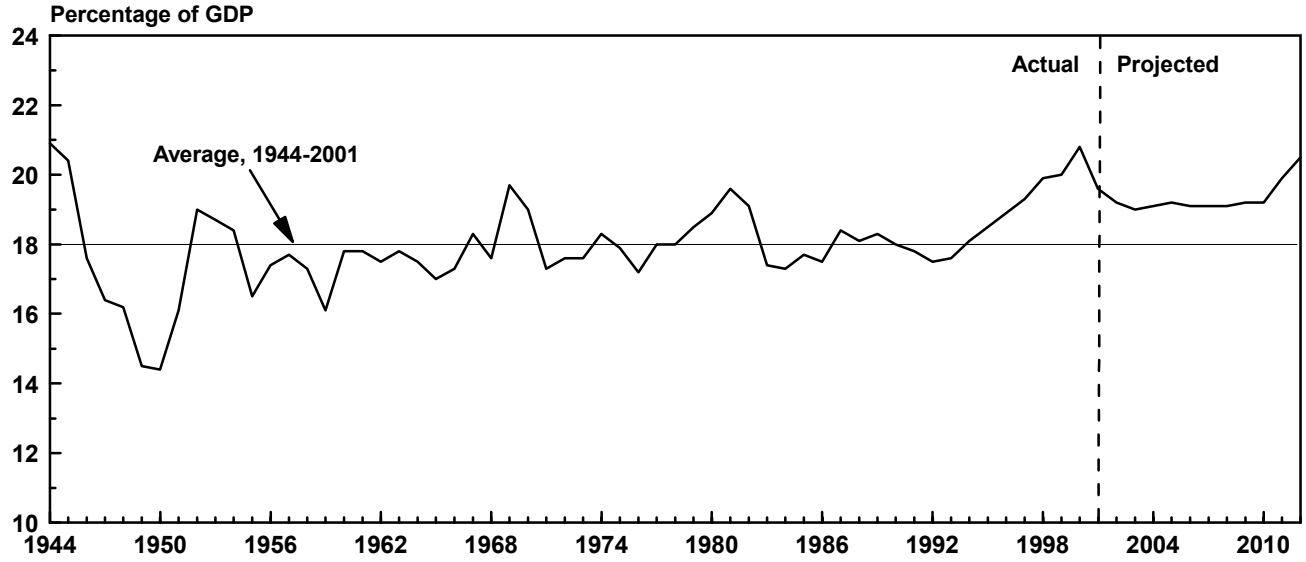
A combination of economic circumstances and tax legislation is expected to cause receipts to grow more slowly than gross domestic product, or output, in 2003; thereafter, revenues grow roughly in tandem with GDP until 2011 (see Figure 3-1). At that point, CBO projects that revenues will increase sharply as a consequence of the expiration of the tax cuts enacted in 2001.

Figure 3-1.
Annual Growth of Federal Revenues and GDP, 1956-2012



SOURCE: Congressional Budget Office.

Figure 3-2.
Total Revenues as a Share of GDP, 1944-2012



SOURCE: Congressional Budget Office.

CBO's current projections contrast sharply with the pattern of receipts from just a few years ago. From 1994 to 2000, revenues rose at an average annual rate of 8.3 percent, a much faster rate of growth than that of GDP. As a result, revenues as a share of output climbed from 18.1 percent in 1994 to 20.8 percent in 2000 (see Figure 3-2). Nonetheless, CBO's projections of revenues relative to GDP for 2002 through 2012 are still well above their average over roughly the past half century.

Changes in CBO's Revenue Projections Since January 2001

In January 2001, CBO projected that revenues would total about $28 trillion over the 2002-2011 period. Its overall projection now, for the same period, is about $2.4 trillion less (see Table 3-1). The altered outlook for revenues is principally responsible for the decline in projected surpluses over the next 10 years. The main factors that led to CBO's new lower estimates of revenues are the tax cuts contained in the Economic Growth and Tax Relief Reconciliation Act of 2001 (Public Law 107-16), which was signed into law last June, and the recession that began in March.

EGTRRA's provisions affect several components of the tax code. The law created a 10 percent marginal income tax bracket and gradually reduces four of the five existing marginal rates.[1] It also expands the child credit, softens the impact of the "marriage penalty" (which causes two married earners to pay more in taxes than they would if they were both single) by adjusting marginal rate brackets and the standard deduction, and provides additional tax incentives to save for retirement and education. In addition, the legislation repeals the current restrictions on itemized deductions and exemptions for higher-income taxpayers. Through 2004, the law provides some relief for taxpayers subject to the alternative minimum tax (AMT). EGTRRA also

1. Calculating a person's tax liability, or tax owed, involves measuring his or her total income, excluding particular kinds of income, to obtain adjusted gross income; subtracting personal and dependent exemptions and various deductions to determine taxable income; applying a set of six statutory marginal tax rates to different ranges of income; and subtracting any applicable credits. In addition, calculations must take account of income ranges over which certain tax provisions phase in or out, granting some or none of various deductions, exemptions, or credits. See Box 3-1 on pages 52 and 53 for more information on rates, tax bases, and tax liability as well as other revenue-related terms.

Table 3-1.
Changes in CBO's Baseline Projections of Revenues Since January 2001 (In billions of dollars)

	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2002-2011
January 2001 Baseline Revenues	2,135	2,236	2,343	2,453	2,570	2,689	2,816	2,955	3,107	3,271	3,447	27,886
Legislative Changes	-72	-32	-86	-103	-103	-128	-144	-152	-160	-178	-119	-1,205
Economic Changes	*	-148	-123	-80	-65	-56	-51	-47	-45	-45	-48	-708
Technical Changes	*	-73	-63	-64	-60	-57	-53	-50	-45	-41	-3	-510
Subtotal	-72	-221	-186	-144	-125	-113	-104	-97	-90	-86	-51	-1,218
Total Changes	-144	-253	-273	-247	-228	-242	-248	-249	-250	-264	-170	-2,423
January 2002 Baseline Revenues	1,991	1,983	2,070	2,206	2,342	2,447	2,568	2,706	2,856	3,008	3,277	25,464

SOURCE: Congressional Budget Office.

NOTES: Legislative changes are as estimated at the time of enactment.

* = unavailable (CBO did not break out the economic and technical changes for 2001).

phases out the estate tax by 2010. In addition, it permitted businesses to shift payment of their corporate estimated income taxes from the final month of fiscal year 2001 (September) to the first month of fiscal year 2002 (October). All of its provisions still in effect in 2010 expire at the end of that year.

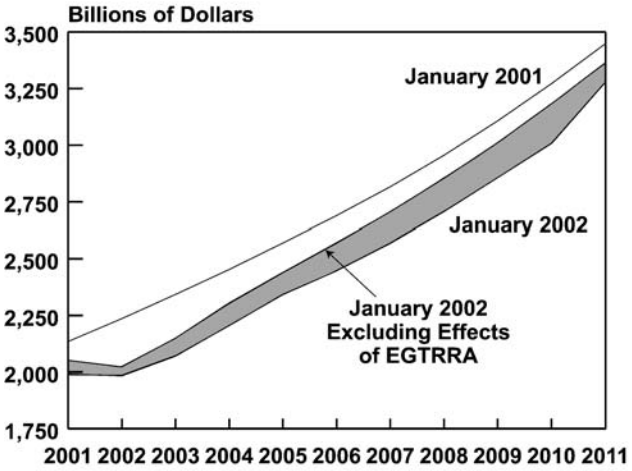
EGTRRA accounts for approximately half of the decrease from last January in the revenues projected for the 2002-2011 period. Most of that reduction—more than $1 trillion of it—is in the category of individual income tax receipts;[2] lower receipts from estate and gift taxes account for over $100 billion of it. Other legislation—principally the Railroad Retirement and Survivors Improvement Act of 2001 (P.L. 107-90), the Investor and Capital Markets Fee Relief Act (P.L. 107-123), and the Victims of Terrorism Tax Relief Act (P.L. 107-134)—accounts for an additional $19 billion of the decrease in projected revenues over the period.[3]

In addition to its impact on the level of overall receipts, EGTRRA also significantly affects the pattern of revenues that CBO projects over the 2002-2012 period (see Figure 3-3 and Table 3-2). First, delaying corporate estimated payments that would normally be due in September 2001 prunes receipts for that fiscal year by about 0.2 percent of GDP and raises receipts for 2002 by the same amount. That shift slightly distorts the apparent contribution of the current recession to the projected drop in corporate income tax revenues. Second, the sequence of reductions in individual income tax rates from 2001 to 2006, which are provided under EGTRRA, offsets increases that would otherwise have occurred in effective individual income tax rates as real (inflation-adjusted) economic growth places more income in the higher tax brackets. Third, the expiration of the law's provisions creates dramatic changes in receipts in the final two years of the projection period. EGTRRA's tax cuts expire at the end of 2010, but the

2. Some of the tax benefits under EGTRRA—about $90 billion over 10 years—are counted as outlays. They consist of child tax credits and earned income tax credits that exceed taxpayers' tax liability and therefore represent payments by the government to individuals.

3. For the purpose of accounting for the changes in CBO's projections, the effects of legislation shown in Table 3-1 are the effects that were estimated at the time of each law's passage. The CBO baselines against which those effects were measured incorporated estimates of economic activity that were higher than those used in the current baseline. Hence, estimates of the loss in revenues from the legislation passed since January 2001 would tend to be smaller if they were calculated now, using the current baseline. The effects of EGTRRA shown in Figure 3-3 and Table 3-2 reflect CBO's current baseline and latest information on the economy; thus, they differ from the effects incorporated in the estimates of Table 3-1.

Figure 3-3.
CBO's Baseline Projections of Total Revenues, 2001-2011



SOURCE: Congressional Budget Office.

NOTE: EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001. The shaded region represents the projected effects of EGTRRA on revenues.

legislation still reduces receipts in 2011 because of both the lag between when tax liability is incurred and when it is paid and the overlap of fiscal and calendar years. By 2012, CBO expects, receipts will be roughly back at the level they would have reached had the legislation not been enacted.

Most of the remaining changes since last January in CBO's projections of revenues are due to an altered picture of economic conditions. The recession slowed the growth of wages and salaries, which constitute the tax base for payroll taxes and make up the biggest part of the individual income tax base. In addition, corporate profits fell steeply, reducing receipts from the corporate income tax. CBO has also slightly lowered its projections of economic growth over the longer term (the later years of the 2002-2012 period). The altered estimates of overall economic activity that CBO is now incorporating in its baseline account for about $700 billion of the projected reduction in revenues.

What CBO terms "technical changes" in its projections (changes that are not driven by new legislation or by modifications to CBO's macroeconomic forecast) also arise largely from economic conditions. The decline in the stock market trimmed capital gains realizations and the receipts they generate in both the individual and corporate income tax categories. CBO's projections also reflect slower growth in overall wealth, which reduces revenues from estate and gift taxes. In addition, total receipts are lower for reasons that are not entirely understood; over the past year, collections have been smaller than those projected by CBO's economic forecasting and revenue-estimating models. Overall, technical changes account for about $500 billion of the reduction that CBO has made in its revenue projections since January 2001.

Much of the decline in projected receipts attributable to the current slowdown in economic growth is likely to be temporary. As the economy recovers, CBO estimates that tax receipts will rise closer to the levels it projected last January. But some of the drop in revenues, relative to those levels, will persist, CBO forecasts, because of slightly slower rates of economic growth over the longer term. In addition, CBO assumes that the portion of the shortfall in current collections not otherwise explained by legislation or economic performance will remain. As a result, CBO's revenue projection for 2011 is still about $50 billion lower (excluding legislative changes) in the current outlook than in last January's.

Revenues by Source

The sources of federal revenues are individual income taxes, corporate income taxes, social insurance taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. Individual income taxes produce about half of all revenues and claim roughly 10 percent of GDP (see Table 3-3 and Figure 3-4). Social insurance taxes (mainly Social Security and Medicare Hospital Insurance taxes) are the second largest source of receipts, equaling about a third of total revenues and a little less than 7 percent of GDP. Corporate income taxes contribute about 10 percent of overall revenues and represent approximately 1.5 percent to 2 percent of output. Revenues from the other taxes and duties and miscellaneous receipts, including profits from the Federal Reserve System, make up the balance—and represent about 1.5 percent of GDP.

Table 3-2.
Estimated Effects on Revenues of the Economic Growth and Tax Relief Reconciliation Act of 2001, 2001-2011 (In billions of dollars)

Tax Receipts	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	Total, 2001-2011
Individual Income	-38	-62	-75	-86	-96	-116	-127	-134	-140	-149	-57	-1,079
Estate and Gift	0	*	-4	-4	-7	-4	-10	-12	-13	-24	-29	-108
Corporate Income[a]	-23	23	0	-7	7	0	0	0	0	0	0	0
Other	0	*	-1	-1	-1	-1	-1	-1	-1	-1	*	-10
Total	-61	-40	-79	-97	-98	-122	-138	-147	-155	-175	-86	-1,197

SOURCE: Congressional Budget Office.

NOTES: EGTRRA's effects on revenues are estimated on the basis of CBO's current economic forecast and estimating assumptions. In contrast, the effects of legislation shown in Table 3-1 (which include those of other laws besides EGTRRA) incorporate estimates of the laws' effects that were produced at the time of enactment and that were based on CBO's economic projections at that time.

EGTRRA's effects on revenues in 2012 are insignificant because the entire law expires at the end of 2010.

Not included here are the law's effects on refundable outlays. At the time of enactment, CBO estimated that such outlays would increase by between $6 billion and $12 billion annually from 2002 through 2011.

* = loss of less than $500 million.

a. These effects derive from changes in due dates for estimated payments.

Rising *individual income tax receipts,* bolstered primarily by increases in capital gains realizations and in the effective tax rate, fueled the rapid growth of total revenues from 1994 to 2000. The higher level of realizations stemmed largely from sharply rising stock prices over that span; increases in the effective tax rate were partly the result of rapidly rising income among higher-income taxpayers, who are taxed at higher marginal rates. Now, both of those effects appear to have leveled out or reversed course. That change, combined with the effects of EGTRRA, contributes to the slower growth of revenues that CBO anticipates for the next few years.

The pattern of individual income tax receipts in CBO's projections incorporates the offsetting effects of several phenomena. Capital gains realizations revert to their historical relationship with GDP, which tends to slow the rise of revenues relative to that of output. In addition, the growth of income of higher-income taxpayers declines to a pace that is consistent with longer-term trends—which also tends to slow the rate of revenue growth relative to the growth of GDP. The higher nominal incomes in CBO's projections tend to raise the average effective tax rate, as more taxpayers become subject to the AMT, and growth in real income subjects more income to higher marginal tax rates (a phenomenon known as "real bracket creep"). Both of those outcomes tend to boost the growth of receipts over the projection period. Finally, the cuts in marginal tax rates scheduled to take effect under EGTRRA tend to reduce income tax receipts relative to GDP.

These offsetting effects, CBO projects, will remain in rough balance through 2010. CBO estimates that at first, they will cause individual income tax receipts to decline slightly relative to GDP, as the effects from capital gains realizations, income growth among high earners, and EGTRRA rate cuts predominate. Then CBO expects individual income tax revenues to rise relative to GDP, as the effects of real bracket creep and the AMT grow stronger. EGTRRA expires as of January 2011, and CBO estimates that at that point, receipts as a share of GDP will begin to climb rapidly.

Table 3-3.
CBO's Baseline Projections of Revenues

Receipts	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007[a]	Total, 2003-2012[a]
						In Billions of Dollars								
Individual Income Tax	994	947	998	1,059	1,114	1,162	1,228	1,305	1,387	1,477	1,673	1,841	5,562	13,245
Corporate Income Tax	151	179	175	199	235	246	260	275	289	303	319	335	1,115	2,635
Social Insurance Tax	694	710	748	789	832	869	908	948	994	1,045	1,097	1,151	4,146	9,381
Excise Tax	66	67	70	72	75	77	79	82	85	87	90	93	373	810
Estate and Gift Tax	28	26	24	25	22	25	22	23	25	16	15	44	119	241
Customs	19	20	21	22	23	24	25	26	26	27	28	29	114	250
Miscellaneous	38	33	34	39	42	44	46	48	50	52	55	57	205	467
Total	1,991	1,983	2,070	2,206	2,342	2,447	2,568	2,706	2,856	3,008	3,277	3,549	11,633	27,030
On-budget	1,484	1,464	1,525	1,632	1,739	1,816	1,907	2,014	2,130	2,243	2,474	2,706	8,620	20,187
Off-budget[b]	508	518	545	574	602	631	661	693	727	764	803	842	3,014	6,842
						As a Percentage of GDP								
Individual Income Tax	9.8	9.2	9.2	9.2	9.2	9.1	9.1	9.2	9.3	9.4	10.2	10.6	9.1	9.5
Corporate Income Tax	1.5	1.7	1.6	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.8	1.9
Social Insurance Tax	6.8	6.9	6.9	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	6.8	6.7
Excise Tax	0.7	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.6	0.6
Estate and Gift Tax	0.3	0.3	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.3	0.2	0.2
Customs	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
Miscellaneous	0.4	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
Total	19.6	19.2	19.0	19.1	19.2	19.1	19.1	19.1	19.2	19.2	19.9	20.5	19.1	19.4
On-budget	14.6	14.2	14.0	14.1	14.3	14.2	14.2	14.2	14.3	14.3	15.0	15.6	14.2	14.5
Off-budget[b]	5.0	5.0	5.0	5.0	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9	4.9

SOURCE: Congressional Budget Office.

a. Numbers in the second half of the table are shown as a percentage of total GDP for this period.

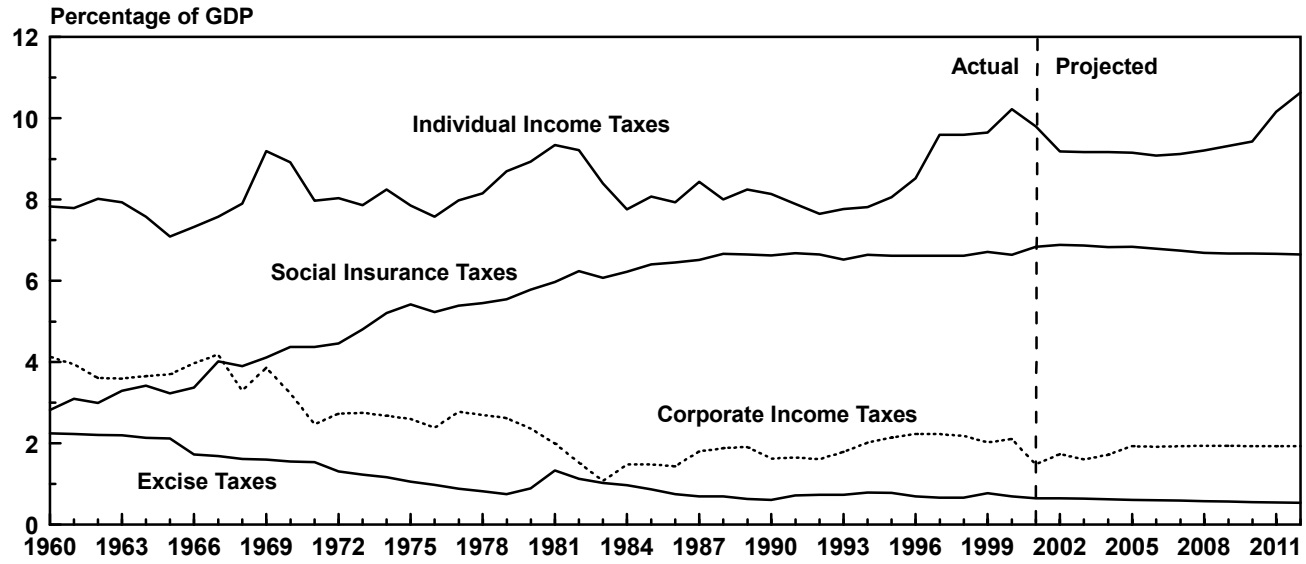
b. Social Security.

The share of output claimed by *social insurance taxes* has changed little over the past decade. From 2002 through 2012, receipts from those taxes are also expected to remain essentially stable, falling only very slightly relative to GDP.

Corporate income taxes contributed some of the increase in revenues in the 1990s as corporate profits surpassed their performance of the 1970s and 1980s. But the current recession has substantially reduced profits—and therefore corporate income tax receipts. Those receipts (which CBO adjusted to take into account the shift in the timing of collections legislated by EGTRRA) fell from 2.1 percent of GDP in 2000 to 1.7 percent in 2001; CBO expects them (again, after adjusting for the timing shift) to fall to 1.5 percent of GDP in 2002. The ratio of receipts to GDP is projected to climb back to 1.9 percent by 2005 and remain near that level through 2012. However, that share of GDP is smaller than the unusually large shares seen just a few years ago.

Excise taxes are a relatively small source of revenues. CBO projects that over the 2001-2012 period, they will decline slightly relative to GDP, dropping from 0.7 percent to 0.5 percent. The excise tax component of receipts is expected to contract relative to GDP because the real value of excise tax receipts tends to fall with inflation. Many such taxes are levied per unit of a good or per transaction rather than as a percentage of value. Excise receipts therefore tend to rise mainly with increases in real, rather than nominal, GDP.

Figure 3-4.
Revenues, by Source, as a Share of GDP, 1960-2012



SOURCE: Congressional Budget Office.

In its current outlook for revenues, CBO expects receipts from *estate and gift taxes* to change in importance over the projection period: their share of GDP is forecast to decline from 0.3 percent to 0.1 percent by 2010 and 2011 before jumping back to 0.3 percent in 2012. That pattern results from phasing out the estate tax under EGTRRA and subsequently reinstating it after the law expires at the end of 2010.

CBO estimates that the share of GDP claimed by all other sources of revenues—customs duties and miscellaneous receipts, including receipts from the Federal Reserve System—will remain steady at just above 0.5 percent throughout the projection period.

Individual Income Taxes

Individual income taxes accounted for most of the expansion of the GDP share of revenues that occurred from the early 1990s to 2000. With the exception of 1998, when individual income tax receipts were reduced by the cuts enacted in the Taxpayer Relief Act of 1997, the rate of growth of those receipts averaged more than 10 percent a year from 1993 to 2000. Their share of GDP reached a historical peak—10.3 percent—in that latter year. The tax cut that became law in June of last year and the recession that began in March halted that trend. Nonetheless, because the tax cuts under EGTRRA expire at the end of 2010, CBO expects individual income tax receipts to rise again, to 10.2 percent of GDP, in 2011 and reach a new historical peak, 10.6 percent, in 2012 (see Table 3-4). Indeed, throughout the entire 2002-2012 period, individual income tax receipts relative to GDP are projected to remain well above their post-World War II average of 8.1 percent. CBO estimates that in every year of the period, they will reach or exceed 9.1 percent, a level that has been surpassed only eight times in the history of the income tax.

CBO's projections of individual income tax receipts over the 2002-2011 period are nearly $1.8 trillion lower than its January 2001 projections for the same span. EGTRRA's tax cuts account for more than $1 trillion of that fall. Approximately $400 billion of the decline is due to the revisions in CBO's macroeconomic forecast, and about $300 billion derives from technical factors closely related to that revised economic outlook. The most influential of those factors were the revisions CBO made in its projections of capital gains realizations and its adjustments for lower-than-expected tax collections since last January. Several minor changes in CBO's projection methods also contributed a small amount to the reduction in the projections.

Table 3-4.
CBO's Baseline Projections of Individual Income Tax Receipts and the Individual Income Tax Base

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Individual Income Tax Receipts														
In billions of dollars	994	947	998	1,059	1,114	1,162	1,228	1,305	1,387	1,477	1,673	1,841	5,562	13,245
As a percentage of GDP	9.8	9.2	9.2	9.2	9.2	9.1	9.1	9.2	9.3	9.4	10.2	10.6	n.a.	n.a.
Annual rate of growth	-1.0	-4.7	5.4	6.1	5.1	4.4	5.7	6.2	6.3	6.5	13.3	10.0	n.a.	n.a.
Taxable Personal Income														
In billions of dollars	7,355	7,501	7,864	8,280	8,651	9,048	9,471	9,917	10,385	10,883	11,402	11,938	43,314	97,840
As a percentage of GDP	72.5	72.7	72.2	71.7	71.1	70.7	70.3	70.0	69.7	69.5	69.2	68.9	n.a.	n.a.
Annual rate of growth	5.9	2.0	4.8	5.3	4.5	4.6	4.7	4.7	4.7	4.8	4.8	4.7	n.a.	n.a.
Individual Receipts as a Percentage of Taxable Personal Income	13.5	12.6	12.7	12.8	12.9	12.8	13.0	13.2	13.4	13.6	14.7	15.4	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: The tax base in this table (taxable personal income) reflects income as measured by the national income and product accounts rather than as reported on tax returns. See Box 3-1 for a discussion of tax bases.

n.a. = not applicable.

The Growth of Receipts Until 2000. Historically, revenues from individual income taxes have tended to grow slightly faster than GDP—but a few exceptions to that tendency are notable. In 1969, for example, a surtax caused income tax receipts to grow significantly faster than output; also, before the tax code was indexed for the effects of inflation on tax brackets, price increases pushed the growth of income tax revenues well above that of the economy by effectively decreasing the levels of real income at which higher tax rates applied. From 1994 to 2000, however, individual income tax receipts grew much faster than gross domestic product—and for entirely different reasons.

Understanding the growth of individual income tax receipts over that earlier period helps explain the pattern of receipts projected for the years from 2002 through 2012. CBO examined a sample of detailed tax-return data from tax years 1994 through 1999 (tax years are essentially the same as calendar years) to identify the sources of that growth. (Although detailed data for 2000 are not available, the same forces were probably at work in that year as well.) The surge in individual income tax liabilities as a percentage of GDP can be traced to four sources (see Table 3-5).[4]

The rapid growth of components of GDP that are taxable to individuals was the first significant source of the surge. (For more information on the relationship between tax liability, taxable income, and GDP, see Box 3-1.) Taxable personal income—which is the sum of wages, interest, dividends, proprietors' income, and rental income as measured in the national income and product accounts—grew faster than GDP during most of the 1994-1999 period. The resulting rise in the ratio of taxable personal income to total output boosted the tax base for the individual income tax and accounted for about 16 percent of the growth of tax liabilities in excess of the growth of GDP over that period.

4. CBO calculated the percentage contribution of each of the four sources using the amount of tax liability that would have accrued without the child and education tax credits that became effective in tax year 1998. Excluding those credits allows consistent measurement across all years in the comparison.

Table 3-5.
Sources of Growth of Individual Income Tax Liabilities in Excess of Growth of GDP, Tax Years 1995-1999 (As a percentage of total liabilities)

Source of Growth of Tax Liabilities	1995	1996	1997	1998	1999	Total, 1995-1999[a]
Taxable Personal Income (TPI) Grew Faster than GDP	21	12	14	42	-3	16
Adjusted Gross Income (AGI) Grew Faster than TPI						
Capital gains tax receipts grew faster than TPI	20	52	29	12	36	30
Other AGI grew faster than TPI	15	5	10	-4	22	10
Changes in the Effective Rate on AGI						
Effect of real growth on rate	30	20	34	30	25	28
Remaining growth from changes in effective rate	14	11	13	20	19	16
Total	100	100	100	100	100	100
Memorandum:						
Growth of Individual Income Tax Liabilities in Excess of Growth of GDP (Billions of dollars)	27	39	35	42	57	199

SOURCE: Congressional Budget Office using data from the Internal Revenue Service's *Statistics of Income, 1994-1999*.

NOTE: See Box 3-1 for a discussion of TPI, AGI, and effective rates.

a. The estimates of tax liabilities for 1998 and 1999 do not include the child and education credits enacted in the Taxpayer Relief Act of 1997.

The next two sources of the surge in individual income tax receipts are components of adjusted gross income, or AGI (the actual income base of the individual income tax), that grew more rapidly than taxable personal income over the period. The first component, capital gains realizations (which are not included in either GDP or taxable personal income), accounts for a large part of the growth in AGI. Between 1994 and 1999, realizations of gains nearly quadrupled, with much of that increase occurring before the cut in capital gains tax rates in 1997 (see Table 3-6). Thus, over the period, taxes on gains accounted for roughly 30 percent of the increased growth of individual income tax liabilities relative to the growth of GDP.

The second AGI-related source of the individual income tax surge comprises other components of the AGI measure that are not part of taxable personal income or GDP and that also expanded more rapidly than either of those measures. Among those components, retirement income in the form of distributions from 401(k) plans and individual retirement accounts, and taxable Social Security benefits were especially prominent. The growth of retirement and nonretirement AGI components together accounted for about 10 percent of the increase in liabilities relative to GDP growth from 1994 to 1999.

The fourth and most significant source of income tax liability growth relative to that of GDP was the increase in the effective tax rate on individual income (see Figure 3-5). In tax years 1995 to 1999, increases in the effective rate (on income other than capital gains) accounted for more than 40 percent of the growth of liabilities in excess of the growth of GDP. Increases in real income for taxpayers generally pushed more income into higher tax brackets. That phenomenon alone accounted for more than half of the increase in the ratio of income tax liability to GDP that resulted from the rise in the effective tax rate. Much of the remaining increase in the effective rate appears to result from the concentration of income growth at the top of the income distribution, which led to a greater proportion of income being taxed at the highest rates. Thus, even though no in-

Box 3-1.
Tax Bases and Tax Liability

Tax receipts vary with economic activity, but they do not move in lockstep with gross domestic product (GDP), or output. Although the bases for taxes on individual and corporate income and for social insurance taxes are related to that economic measure, they differ from GDP in a number of important respects, which means that they sometimes grow faster and sometimes slower than output. As a result, the ratio of receipts to GDP may change even if tax laws remain the same.

The Individual Income Tax Base

Taxable personal income is the first approximation of the individual income tax base. It comprises dividends, interest, wages and salaries, rent, and proprietors' income. It does not include depreciation, indirect taxes on businesses (such as excise taxes), fringe benefits, or retained corporate profits.

Despite its name, not all taxable personal income is actually taxed. Some of it accrues to tax-exempt entities such as hospitals, schools, cultural institutions, and foundations; some is earned in a form that is tax-exempt, such as income from state and local bonds; and some is tax-deferred, such as in the case of income from retirement accounts, on which the tax is paid not when the income is earned but when the person retires and begins to draw down the account. Also, personal interest and rental income comprise large components of imputed income—income that is not earned in a cash transaction, including personal earnings within pension funds and life insurance policies and income from owner-occupied housing—that are not taxable. Consequently, a substantial amount of interest, dividend, and rental income is excluded from the taxable base of the income tax.

Taxpayers make further adjustments, both additions and subtractions, to taxable personal income to derive **adjusted gross income**, or AGI. **Capital gains realizations**—the increase in the value of assets between the time they are purchased and sold—are added to taxable personal income. Contributions from income to tax-deductible individual retirement accounts and 401(k) programs are subtracted, but distributions to retirees from those programs are added. Taxpayers also make a variety of other, smaller adjustments.

Exemptions and **deductions** are subtracted from AGI to yield taxable income, to which progressive tax rates—that is, rates that rise as income rises—are applied. (Those rates are known as **statutory marginal tax rates**; the range of taxable income over which a statutory marginal rate applies is known as an **income tax bracket**, of which there are currently six.) The resulting tax may then be subject to further adjustments in the form of **credits**, such as the child tax credit for taxpayers with children under age 17, which reduce the taxpayers' **tax liability** (the amount of taxes they owe). An important factor in calculating individual tax liability is the **alternative minimum tax** (AMT), which requires some taxpayers to calculate their taxes under a more limited set of exemptions, deductions, and credits. Taxpayers then pay the higher of the AMT or the ordinary tax. The ratio of tax liability to AGI is called the **effective tax rate on AGI**.

come group was subjected to higher statutory tax rates, a larger share of income accruing to taxpayers facing the top tax rates raised the effective rate overall.[5]

The Decline of Receipts in 2001. After several years in which actual revenues exceeded CBO's projections, individual income tax receipts in 2001 fell short of the estimates of them that CBO had made in January of that year. CBO projected that individual income tax receipts would total $1,076 billion, but actual receipts in 2001 were about $80 billion less, or $994 billion. About half of that reduction came from the cut in marginal tax rates enacted in EGTRRA; the legislation created a 10 percent tax bracket and "rebated," in 2001, the tax savings that otherwise would have shown up largely in 2002. And as economic growth slowed to a level below that underlying CBO's earlier projections, revenues also ebbed. In addition, at least some of the phenomena responsible for the rise in individual income tax receipts relative to GDP from 1994 to 2000 waned in 2001.

On the basis of figures from the Department of the Treasury, the early rebate under EGTRRA reduced receipts for 2001 by about $35 billion. Other EGTRRA provisions were probably responsible for an additional decline of $3 billion in withholding and other individual income tax receipts. Of the remaining shortfall (compared with what CBO had projected) of $42 billion, about $10 billion resulted from the slowdown in the growth of GDP and in those of

5. See Congressional Budget Office, *Effective Federal Tax Rates, 1979-1997* (October 2001).

Box 3-1.
Continued

The Corporate Income Tax Base

Corporate profits are the tax base of the corporate income tax. But the corporate profits component of GDP differs in several important respects from what is taxed by the corporate income tax.

First, the profits of the Federal Reserve System are counted as corporate profits in measures of GDP, but they are not taxed under the corporate income tax (they are instead remitted to the Treasury as miscellaneous receipts).

Second, measures of GDP calculate corporate income on the basis of **economic depreciation**—the dollar value of productive capital assets that is estimated to have been used up in the production process. For tax purposes, however, corporations calculate **book profits**, which are based on **book**, or **tax, depreciation**. Book depreciation is typically more front-loaded than economic depreciation; that is, the capital is assumed to be used up at a faster rate than the best estimates of how fast it is actually used up, allowing firms to report taxable profits that are smaller than economic profits.

Third, taxable corporate income includes the foreign-source income of U.S. multinational corporations when that income is "repatriated," or returned, to the U.S. parent company. Foreign-source income is not part of measured output.

Several other, smaller differences exist between corporate profits as defined in the GDP measure and corporations' calculation of their **taxable income** for tax purposes. If a corporation's taxable income is negative (that is, if the firm loses money), its loss (within limits) may be carried backward or forward to be netted against previous or future taxable income and thus reduce the firm's taxes in those other years. A statutory tax rate is applied to the corporation's taxable income to determine its tax liability. A number of credits (such as that for taxes imposed by other countries on the foreign-source income included in a firm's taxable profits) may further pare that liability. The ratio of aggregate domestic corporate taxes to aggregate taxable corporate income is the **average tax rate**.

The Social Insurance Tax Base

Social insurance taxes, the other big source of receipts, use payroll as their base. Those taxes largely fund Social Security and Medicare's Hospital Insurance program (Part A of Medicare). Social Security taxes are imposed as a percentage of pay up to a **taxable maximum** that is indexed for the growth of wages in the economy. Medicare's Hospital Insurance taxes are not subject to a taxable maximum.

Despite many adjustments that must be made to calculate the actual tax bases, a ready approximation is the sum of wages and salaries and corporate book profits (see Chapter 2 for a brief discussion). Those items pick up much of the bases of the individual income, corporate income, and social insurance taxes and therefore constitute the bulk of taxed income.

its components that constitute the tax base.[6] The remaining $30 billion of the decline was due to unexpected changes in the amount of revenue that was generated by the level of economic activity in 2001.

Although capital gains realizations constitute a relatively small percentage of overall tax receipts, they played a significant role in the rise of total revenues relative to GDP in the second half of the 1990s (see Table 3-6). And they are probably a significant factor in the recent shortfall of receipts relative to projections. CBO's January 2001 estimate of capital gains realizations in tax year 2000 is an important calculation in its estimate of receipts for fiscal year 2001, because a portion of the tax resulting from the realizations is paid with the subsequent filing of tax returns, in 2001. CBO's estimate last January was $652 billion; that compares with CBO's best estimate to date of actual realizations, which is about $620 billion. Thus, CBO's projection in January 2001 was relatively accurate, and the rise in gains of about 12 percent was faster than that of GDP. Nevertheless, CBO's best estimate of actual realizations in 2000 represents a level that, while strong, was still lower than the level that CBO had projected last year.

CBO now estimates that capital gains realizations in calendar year 2001 fell by nearly 20 percent, to $500 billion. That drop produces a small estimated decline in capital gains receipts for fiscal year 2001.

6. Of that $10 billion, $6 billion appears as an economic revision to CBO's projections between January 2001 and August 2001. CBO's models suggest that $5 billion of the $20 billion shortfall in actual receipts (relative to the August projections) is due to changes in the economy.

Table 3-6.
Actual and Projected Capital Gains (In billions of dollars)

	Realizations		Liabilities		Receipts[a]		Receipts as a Percentage of Total Individual Income Tax Receipts
	Level (CY)	Percentage Change	Level (CY)	Percentage Change	Level (FY)	Percentage Change	
1990	124	-20	28	-21	32	-14	7
1991	112	-10	25	-11	27	-17	6
1992	127	14	29	16	27	1	6
1993	152	20	36	25	32	20	6
1994	153	0	36	0	36	12	7
1995	180	18	44	22	40	10	7
1996	261	45	66	50	54	36	8
1997	365	40	79	19	72	33	10
1998	455	25	89	12	84	16	10
1999	553	21	112	26	99	19	11
2000	620	12	126	13	118	19	12
2001	500	-19	100	-21	115	-3	12
2002	476	-5	95	-5	98	-15	10
2003	476	0	95	-1	95	-3	10
2004	479	1	95	0	95	0	9
2005	483	1	95	1	95	0	9
2006	492	2	97	2	96	1	8
2007	504	2	99	2	98	2	8
2008	520	3	102	3	100	3	8
2009	539	4	106	3	104	3	7
2010	561	4	110	4	108	4	7
2011	581	4	114	4	112	4	7
2012	604	4	118	4	116	4	6

SOURCES: Congressional Budget Office; Department of the Treasury.

NOTES: CY denotes data on a calendar year basis, and FY denotes data on a fiscal year basis. Realizations represent net positive long-term gains.

Data for realizations and liabilities after 1999 and receipts data for all years are projected by CBO.

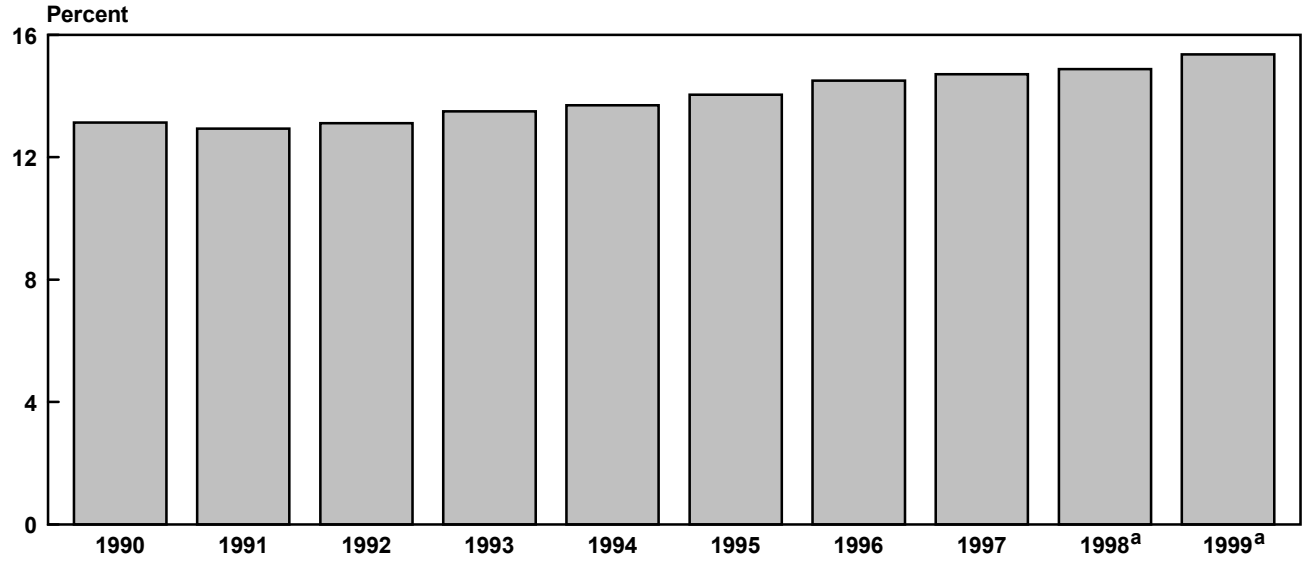
a. The fiscal year receipts measure is CBO's estimate of when liabilities are paid to the Treasury.

A second contributor to the reduction in 2001 in income tax receipts relative to the level of economic activity may have been slower growth in income at the top end of the income distribution. Just as faster-than-average growth of income for very high earners helped fuel the rise in the GDP share of receipts, so slower-than-average growth of that income would accomplish the reverse. Detailed data on taxpayers' incomes are not yet available, but some evidence suggests that income growth at the top end of the income distribution has slowed over the past year.

One source of that growth in the past was income from stock options. Estimates suggest that such income increased to more than $100 billion in 2000, or about 2 percent of wages and salaries. Much of that income presumably accrued to the highest-earning taxpayers and thus was taxed at the highest rates. The weakening of the stock market in 2001 implies that income from stock options declined by perhaps 20 percent to 40 percent from its level in 2000, which means that a larger proportion than before of total wage and salary income was subject to lower marginal tax rates.

Another source of the rapid growth of taxable income among high-earning taxpayers in the late 1990s, CBO believes, was bonuses. Estimates for tax

Figure 3-5.
Effective Tax Rate on Individual Income, Tax Years 1990-1999



SOURCE: Congressional Budget Office.

NOTE: The effective rate is the ratio of tax liability to income. Tax years are essentially the same as calendar years.

a. The estimates of tax liabilities that CBO used to generate the effective rates do not include the child and education credits enacted in the Taxpayer Relief Act of 1997.

year 2001 are not yet available, but anecdotal evidence, as well as preliminary projections from some of the states that closely monitor that source of income, indicates that bonus income in 2001 was lower relative to earlier years.

The Expected Pattern of Future Receipts. CBO estimates that individual income tax receipts will decline in fiscal year 2002. Part of that projected fall results from the tax cuts enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001. Another source is the economy. Although forecasters estimate that it will rebound in the coming months, it will not reach full employment immediately. Thus, the depressed level of economic activity in 2002 is expected to continue to dampen GDP growth and the growth of revenues. In addition, CBO forecasts that indirect effects of that depressed activity on realizations of capital gains and effective tax rates will further reduce receipts from the individual income tax.

From 2003 to 2005, the pattern of revenue growth in CBO's projections is dominated by the nation's recovery from the recession. Over the period, CBO estimates that individual income tax receipts will rise as economic growth picks up. But the path of those receipts over the 10 years from 2003 to 2012 is likely to be influenced by several other factors as well.

First, the provisions of EGTRRA will tend to initially curb and then accelerate the growth of receipts. Under the law, marginal rates drop again in 2004 and 2006. And over the 2006-2010 period, restrictions phase out on itemized deductions and exemptions of high-income taxpayers. Both of those changes will tend to reduce the growth of individual income tax receipts, CBO estimates. But at the end of 2010, all provisions of the law that are still in force expire, and revenues are expected to climb sharply.

Second, on its own, growth in income will tend to increase the relative growth of receipts. Even though the individual income tax is indexed for inflation, the growth of real income will tend to shift a bigger proportion of taxable income into higher tax brackets so that income tax receipts are likely to grow faster than income. Moreover, as income rises, the AMT—which is not indexed for inflation—will affect more taxpayers and more income, providing an additional

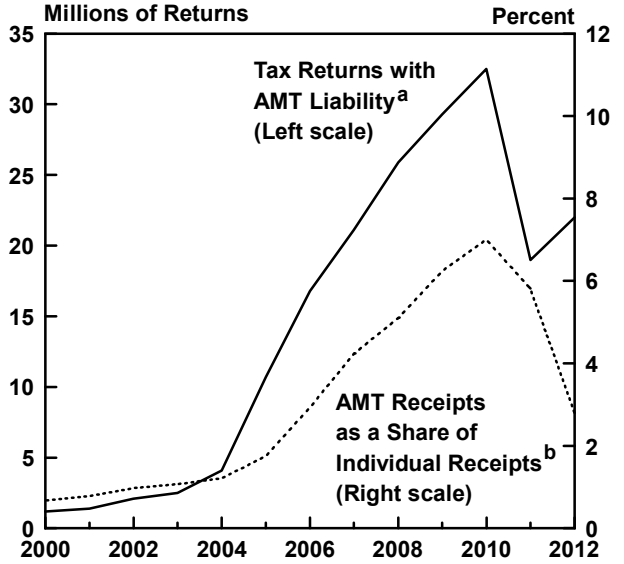
reason that the growth of receipts will tend to outstrip that of income.

Third, the other phenomena that influence the effective tax rate, including capital gains realizations and income growth at the very top of the income distribution, also operate over the 2003-2012 period. On the basis of its estimate of declining capital gains realizations in 2001, CBO expects receipts from gains to fall in 2002. Thereafter, realizations are likely to grow more slowly than overall income as they gradually return to a level consistent with their historical relationship to GDP. That assumed pattern of realizations, CBO estimates, will tend to slow the growth of receipts relative to GDP growth during the period. In addition, CBO assumes that the share of wages going to the highest-earning taxpayers will revert gradually to its longer-term trend, which will tend to reduce receipts relative to GDP during the projection period's first few years.

Until the very end of that period, CBO projects, all of these factors in combination will keep individual income tax receipts roughly constant as a percentage of GDP. The effects of the real growth of income and of the AMT will tend to raise receipts relative to GDP throughout those years. The capital gains effect, in contrast, will tend to lower them, but its impact will be strongest in the period's earlier years. The income distribution effect will also tend to reduce receipts relative to GDP but only in the first few years of the period. Consequently, individual income tax receipts relative to GDP are likely to decline very slightly from 2003 through 2006, but later, after 2006, the effects of the growth of income will begin to dominate and boost receipts relative to GDP. In 2011 and 2012, CBO estimates, the expiration of EGTRRA will swamp all other effects, sharply raising individual income tax receipts as a percentage of GDP.

The effect of the AMT deserves special mention. Provided that tax law does not change, the growth of nominal income will continue to increase both the number of taxpayers and the amount of income subject to the minimum tax. In addition, the marginal rate cuts in EGTRRA will reduce regular tax liability relative to AMT tax liability; that will also tend to increase the contribution that the AMT makes to total revenues. In 2001 through 2004, EGTRRA raises the amount of income that is exempt from the tax, which will temporarily help offset some of the growth in its share of revenues. But the AMT provision in EGTRRA expires at the end of 2004. After that, the number of taxpayers subject to the AMT will rise sharply (see Figure 3-6).

Figure 3-6.
CBO's Projections of the Effects of the Individual Alternative Minimum Tax



SOURCE: Congressional Budget Office.

NOTE: The alternative minimum tax requires some taxpayers to calculate their taxes under a more limited set of exemptions, deductions, and credits than the set applicable under the regular individual income tax.

a. By calendar year.

b. By fiscal year.

Since the remaining provisions of EGTRRA expire at the end of 2010, comparing the number of taxpayers subject to the AMT in 2001 and estimates of the revenues from it with estimates of the same factors in 2012 demonstrates how the AMT's effects increase as a result of the growth of nominal income. CBO estimates that in 2001, 1.4 million tax returns will report AMT liability in the tax year, and receipts from the AMT will total $8 billion in the fiscal year. In 2012, about 22 million returns will have AMT liability, and the tax will add $50 billion to revenues. Thus, over that span, the relative importance of the

AMT as a percentage of total individual income tax receipts more than triples.

The rise and fall of the AMT's projected effects between 2004 and 2011 parallel the phasing in and expiration of the cuts in the tax that are part of EGTRRA. The number of returns that the AMT affects rises from 2.5 million in tax year 2003 to about 32 million in 2010. In fiscal year 2010, the AMT adds more than $100 billion to revenues from the regular tax, or about 7 percent of total individual income tax receipts. The differences between 2010 and 2012 in AMT receipts ($50 billion) and returns affected (10 million) indicate the degree to which the cuts in marginal tax rates under EGTRRA have less than their full effect because of the alternative minimum tax.

Corporate Income Taxes

In recent years, receipts from the corporate income tax and profits both grew more rapidly than the overall economy. From 1994 to 2000, corporate income tax receipts as a percentage of GDP were 2 percent or more, levels not achieved since 1980. That performance was largely driven by very strong corporate profits. In 2001, however, corporate profits and cor-

Table 3-7.
CBO's Baseline Projections of Corporate Income Tax Receipts and Tax Bases

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Corporate Income Tax Receipts														
In billions of dollars	151	179	175	199	235	246	260	275	289	303	319	335	1,115	2,635
As a percentage of GDP	1.5	1.7	1.6	1.7	1.9	1.9	1.9	1.9	1.9	1.9	1.9	1.9	n.a.	n.a.
Annual rate of growth	-27.1	18.5	-2.1	13.6	18.1	4.5	6.0	5.7	5.0	4.9	5.1	5.1	n.a.	n.a.
Corporate Book Profits														
In billions of dollars	748	625	736	873	955	1,025	1,087	1,152	1,213	1,273	1,341	1,407	4,675	11,061
As a percentage of GDP	7.4	6.1	6.8	7.6	7.8	8.0	8.1	8.1	8.1	8.1	8.1	8.1	n.a.	n.a.
Annual rate of growth	-11.8	-16.4	17.7	18.6	9.4	7.3	6.1	6.0	5.3	4.9	5.4	4.9	n.a.	n.a.
Taxable Corporate Profits[a]														
In billions of dollars	610	522	609	712	773	825	872	922	969	1,015	1,069	1,120	3,791	8,885
As a percentage of GDP	6.0	5.1	5.6	6.2	6.4	6.4	6.5	6.5	6.5	6.5	6.5	6.5	n.a.	n.a.
Annual rate of growth	-14.5	-14.3	16.6	16.9	8.5	6.7	5.8	5.7	5.2	4.7	5.3	4.8	n.a.	n.a.
Corporate Receipts as a Percentage of Taxable Profits	24.8	34.3	28.8	27.9	30.4	29.8	29.8	29.8	29.8	29.9	29.8	29.9	n.a.	n.a.
Adjusted Corporate Receipts as a Percentage of Taxable Profits[b]	28.5	29.9	28.8	28.9	29.6	29.8	29.8	29.8	29.8	29.9	29.8	29.9	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: The tax bases in this table (corporate book profits and taxable corporate profits) reflect income as measured by the national income and product accounts rather than as reported on tax returns. See Box 3-1 for a discussion of tax bases.

n.a. = not applicable.

a. Taxable corporate profits are defined as book profits minus profits earned by the Federal Reserve System, transnational corporations, and S corporations and minus deductible payments of state and local corporate taxes. They include capital gains realized by corporations.

b. Excludes the shift in corporate receipts from 2001 to 2002 and from 2004 to 2005 enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001.

porate income tax receipts as a percentage of GDP slipped substantially because of the effects of the recession and of EGTRRA.

As noted earlier, EGTRRA delayed corporate estimated payments from September 2001 to October and the new fiscal year, shifting approximately $23 billion in revenues and distorting the pattern of corporate receipts. After adjusting its calculations to account for the shift, CBO estimates that corporate tax revenues fell from $207 billion in 2000 to $174 billion in 2001; it expects them to fall to $156 billion in 2002. That overall projected decline is almost entirely due to the slowing of the economy. Because corporate profits have fallen relative to total output in CBO's projections, corporate tax receipts have followed suit, sliding from 2.1 percent of GDP for 2000 to 1.7 percent (adjusted for the timing shift) for 2001 and 1.5 percent (adjusted) for 2002.

CBO projects that corporate tax receipts will begin to recover in 2003 and that by 2005, the ratio of receipts to GDP will reach 1.9 percent and remain at that level until 2012 (see Table 3-7). Those estimates stem largely from the pattern of profits over time, which is indicated by the measure of the average tax rate (corporate receipts as a percentage of taxable profits). Once the rate is adjusted for the timing shift that affects receipts for 2001 and 2002 and for a second, smaller timing shift between 2004 and 2005, the average tax rate varies within a relatively narrow band of 28.5 percent to 29.9 percent over the rest of the projection period.

The average tax rate includes a cyclical component because profits and losses are treated differently. Firms pay taxes to the government on the profits they earn, but they do not receive payments from it if they lose money (except to the extent that they can carry their losses forward or backward to offset profits in other years). Therefore, when the economy declines and the number of firms losing money increases, corporate tax receipts do not drop by as much as net profits do. That means that the overall effective corporate tax rate (receipts divided by net profits) tends to be higher when economic activity is depressed than when it is not—which explains the rise in the effective corporate tax rate in 2002. The rise in the rate that CBO projects over the longer term (that is, the portion of the rise that is not related to the rate's cyclical component) derives in large part from the expiration of various tax provisions, such as the research and experimentation tax credit, that would otherwise tend to reduce corporate tax liability.

Projections of corporate income tax receipts are always subject to a great deal of uncertainty, although the receipts' relatively small size dampens its effect on projections of total revenues. Much of the uncertainty in corporate tax estimates stems from the fluctuation of corporate profits. Profits are essentially the residual income in an economy—what remains for the owners of firms after all of the other productive inputs (such as labor) have been compensated. As a result, profits tend to vary much more than do other sources of taxable income, and that makes them difficult to project, especially in periods of economic slowdown.

CBO's current projections of corporate income tax receipts for the 2002-2011 period are about $150 billion lower than the amounts it projected last January for the same period. About $60 billion of that reduction flows directly from changes in CBO's economic forecast, and about $120 billion stems from technical changes, some of which derive from reductions in CBO's estimates of corporate capital gains realizations for 2002 through 2011. The technical changes to the projections also reflect lower tax collections in 2001 than would otherwise be expected, given the economic conditions; part of that drop in collections is expected to be permanent. Offsetting some of the reduction in projected corporate tax receipts are the changes CBO made as a result of legislation enacted during the year. Those revisions increase revenues mainly because of the shift of receipts under EGTRRA from 2001 to 2002.

Social Insurance Taxes

In CBO's projections for the 2002-2012 period, revenues from social insurance taxes claim a roughly constant share of wages and salaries (see Table 3-8). By far the largest generators of those receipts are Social Security (Old-Age, Survivors, and Disability Insurance, or OASDI) and Medicare (Hospital Insurance, or HI) taxes (see Table 3-9). A small share of social insurance revenues comes from unemployment insur-

Table 3-8.
CBO's Baseline Projections of Social Insurance Tax Receipts and the Social Insurance Tax Base

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Social Insurance Tax Receipts														
In billions of dollars	694	710	748	789	832	869	908	948	994	1,045	1,097	1,151	4,146	9,381
As a percentage of GDP	6.8	6.9	6.9	6.8	6.8	6.8	6.7	6.7	6.7	6.7	6.7	6.6	n.a.	n.a.
Annual rate of growth	6.3	2.3	5.3	5.5	5.4	4.5	4.4	4.4	4.9	5.1	5.0	4.9	n.a.	n.a.
Wages and Salaries														
In billions of dollars	5,062	5,186	5,461	5,747	6,011	6,301	6,614	6,946	7,296	7,665	8,052	8,460	30,135	68,555
As a percentage of GDP	49.9	50.3	50.2	49.7	49.4	49.2	49.1	49.0	49.0	48.9	48.9	48.9	n.a.	n.a.
Annual rate of growth	6.8	2.5	5.3	5.2	4.6	4.8	5.0	5.0	5.0	5.1	5.1	5.1	n.a.	n.a.
Social Insurance Receipts as a Percentage of Wages and Salaries	13.7	13.7	13.7	13.7	13.8	13.8	13.7	13.6	13.6	13.6	13.6	13.6	n.a.	n.a.

SOURCE: Congressional Budget Office.

NOTES: The tax base in this table (wages and salaries) reflects income as measured by the national income and product accounts rather than as reported on tax returns.

n.a. = not applicable.

ance taxes and contributions to Railroad Retirement and other federal retirement programs.

Social Security and Medicare taxes are calculated as a percentage of covered wages; unlike the Medicare HI tax, which applies to all such wages, Social Security taxes apply only up to a taxable maximum that is indexed to the growth of wages over time. Consequently, receipts from OASDI and HI taxes tend to remain a constant proportion of income as long as covered wages are a steady share of GDP and the distribution of income from wages stays relatively stable.

CBO projects that social insurance tax receipts will decrease slightly relative to GDP over the next decade. That decline is partly the result of the unusually high ratio of social insurance receipts to GDP in 2001: the ratio climbed from 6.7 percent in 2000 to 6.8 percent in 2001 and is expected to rise to 6.9 percent in 2002. Those higher levels are largely a consequence of the recession, which tends to increase the share of total income claimed by wages when corporate profits and interest income fall. The ratio is expected to creep downward as the economy and profits recover.

In general, receipts from Social Security and Medicare taxes over the 2002-2012 period will remain a fairly constant proportion of wage and salary income, CBO estimates. And after the economy swings back to full employment, they will tend to maintain a fairly steady share of GDP. From 2002 to 2005, CBO projects, the ratio of total social insurance receipts to wage and salary income will rise, mainly because state unemployment systems will be replenishing their trust funds in the wake of the outflow of unemployment benefits during the recession. The slow decline in social insurance receipts as a fraction of wages that CBO expects will occur after 2005 is driven largely by three factors: states will have completed replenishing their funds; revenues associated with other federal retirement programs will be lower, as the number of workers covered under Railroad Retirement and the old Civil Service Retirement System dwindles; and a slightly larger fraction of total wage and salary income will be above the cap on earnings subject to Social Security taxes.

Compared with last January's projections, CBO's current estimates of social insurance receipts over the 2002-2011 period are lower by about $130

Table 3-9.
CBO's Baseline Projections of Social Insurance Tax Receipts, by Category (In billions of dollars)

Tax Receipts	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Social Security	508	518	545	574	602	631	661	693	727	764	803	842	3,014	6,842
Medicare	150	152	159	168	176	185	194	204	214	225	237	249	882	2,012
Unemployment Insurance	28	31	35	39	45	45	44	43	45	47	49	51	207	444
Railroad Retirement	4	4	4	4	4	4	4	4	4	4	4	5	21	43
Other Retirement	5	4	4	4	4	4	4	4	4	4	4	3	22	40
Total	694	710	748	789	832	869	908	948	994	1,045	1,097	1,151	4,146	9,381

SOURCE: Congressional Budget Office.

billion. The reductions stem from changes in CBO's projections of wages and salaries as a consequence of the slowdown in economic growth. Part of the overall decrease is offset by technical changes that boost receipts. (The changes are based on information that current collections of OASDI and HI taxes are actually higher than revenue-estimating models predicted, given the level of economic activity.) Although that extra revenue is projected to persist, the increase in collections of social insurance receipts does not result in a net increase in projected total revenues—because the increase in social insurance receipts is linked to an offsetting decrease in individual income tax receipts.

Excise Taxes

Receipts from excise taxes are expected to continue their long-term decline as a percentage of GDP, falling from their share of 0.7 percent in 2001 to 0.5 percent by 2012. Most excise taxes—those generating about 80 percent of total excise revenues—are levied per unit of a good or per transaction rather than as a percentage of value. As a result, excise receipts grow with real output, but they generally do not rise with inflation. Therefore, they do not grow as fast as does nominal GDP.

Nearly all excise taxes fall into five major categories: highway, airport, telephone, alcohol, and tobacco. Almost half of all excise tax receipts are earmarked for (allocated by law to) the Highway Trust Fund; they come primarily from taxes on gasoline and diesel fuel (see Table 3-10). Most airport and telephone excise taxes are levied on a percentage basis, so they grow at a faster rate than do the other categories. CBO's projections of tobacco tax receipts incorporate the effects of a small rate hike enacted in 1997 to take effect on January 1, 2002—which raises the level of receipts for this year. However, the projections also reflect the drop in tobacco consumption that is expected from the rise in tobacco prices resulting from the tobacco industry's settlements with the states. The net effect is that CBO's estimates of receipts from tobacco excise taxes are roughly stable for 2003 through 2012.

CBO's current projections of total excise tax receipts are lower than the estimates it produced last January for the same period (2002 through 2011). Lower projections of aviation-related taxes in the wake of the events of September 11 account for some of the drop. And some of it results from as-yet-unexplained reductions, relative to earlier projections, in the receipts collected for other excise taxes in 2001—a pattern that CBO expects will continue through the 2002-2012 period.

Table 3-10.
CBO's Baseline Projections of Excise Tax Receipts, by Category (In billions of dollars)

	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Highway	33	33	34	35	37	38	39	40	41	42	44	45	183	395
Airport	9	9	10	10	11	12	12	13	14	15	15	16	55	129
Telephone	6	6	6	7	7	8	8	9	9	10	10	11	36	84
Alcohol	8	8	8	8	9	9	9	9	9	9	9	9	43	88
Tobacco	8	8	9	9	9	9	9	9	9	9	9	9	44	87
All Other	3	3	3	3	3	3	3	3	3	3	3	3	13	27
Total	66	67	70	72	75	77	79	82	85	87	90	93	373	810

SOURCE: Congressional Budget Office.

Estate and Gift Taxes

In the past, revenues from estate and gift taxes have tended to grow more rapidly than income because the unified credit for the estate and gift tax, which effectively exempts some assets from taxation, is not indexed for inflation. Under EGTRRA, however, the estate tax phases out, and the gift tax remains in the code but in a modified form. The amount of an estate that the law effectively exempts from tax is scheduled to rise, in a series of steps, from $1 million in 2002 to $3.5 million in 2009. EGTRRA also reduces the highest estate tax rate, from 50 percent in 2002 to 45 percent by 2007. In 2010, the law calls for the estate tax to be eliminated. But the expiration of EGTRRA's provisions at the end of that year means that the tax will be reinstated in 2011. Because of normal lags in the payment of estate tax liability and the retention of the gift tax in the tax code, receipts from estate and gift taxes do not disappear completely in CBO's projections for the 2002-2012 period but instead reach a trough in 2011 (see Table 3-11). CBO estimates that in 2012 they will return to their 2002 level relative to GDP.

CBO's current projections of estate and gift tax receipts are lower than those from January 2001 by about $180 billion. The source of most of that decline was legislation (specifically, EGTRRA), but technical changes also contributed to it. In particular, the weakening of the stock market led CBO to revise its estimates of the household wealth that would be subject to the estate tax.

Other Sources of Revenue

Customs duties and numerous miscellaneous sources bring in much smaller amounts of revenue than do the major levies (see Table 3-11). CBO projects that customs duties will grow over time in tandem with imports. Over the next few years, however, their growth will be curbed as tariff reductions enacted in 1994 are phased in.

The largest component of miscellaneous receipts is the profits of the Federal Reserve System, which are counted as revenues once they are turned over to the Treasury. Those profits depend on the interest earned on the system's portfolio of securities and on gains and losses from its holdings of foreign currency. In recent months, earnings on securities have declined as the central bank engaged in a countercyclical monetary policy of lowering interest rates to try to stimulate economic growth and counter the economy's downturn. In addition, the recession has shrunk the Federal Reserve's portfolio of assets because of slower growth in the public's holdings of

Table 3-11.
CBO's Baseline Projections of Other Sources of Revenues (In billions of dollars)

Receipts	Actual 2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Estate and Gift Tax	28	26	24	25	22	25	22	23	25	16	15	44	119	241
Customs	19	20	21	22	23	24	25	26	26	27	28	29	114	250
Miscellaneous														
Federal Reserve	26	24	25	30	32	34	37	39	41	43	45	47	158	373
Universal Service Fund	5	5	5	6	6	6	6	6	6	6	6	7	28	60
Other	6	4	4	4	4	3	4	3	3	3	3	3	18	35
Subtotal	38	33	34	39	42	44	46	48	50	52	55	57	205	467
Total	85	79	79	86	87	93	92	97	102	95	98	130	438	959

SOURCE: Congressional Budget Office.

U.S. currency. Those declines have led CBO to project that receipts from the Federal Reserve System in 2002 and 2003 will be substantially below the amounts previously projected. The central bank's income, and therefore the receipts it remits to the Treasury, are expected to return to their previous trends in 2004 and 2005.

Another small but significant component of miscellaneous receipts is the Universal Service Fund. Collected from the telecommunications industry, money from the fund is intended to finance Internet service for libraries and schools in low-income areas and to subsidize basic telephone service for high-cost areas and low-income households. CBO's current projections of this source of revenues hover close to $5 billion for each year of the 2002-2012 period, although the level of total receipts expected from this source has fallen compared with the level CBO projected last January. CBO has reduced its projections on the basis of new information about the establishment of state universal service funds (the Telecommunications Act of 1996 permitted the states to set up such funds to collect and disburse money). Receipts from the state funds were factored in to earlier projections of miscellaneous receipts, but CBO now considers it unlikely that the funds will be established. (The drop in receipts that CBO's projections now incorporate is offset on the outlay side of the federal budget, so the overall effect on the budget is neutral.)

A further reduction that CBO has incorporated in its current projections applies to the category of "other" miscellaneous receipts. Provisions of the Investor and Capital Markets Fee Relief Act, which was passed in December 2001, lower the fees that CBO expects the Securities and Exchange Commission (SEC) will receive over the period; the law also reclassifies them as offsetting collections—which appear in the budget as negative outlays rather than revenues.

In sum, the changes in the SEC's fees and the revision related to state universal service funds explain most of the $82 billion decline since last January in CBO's projections of other miscellaneous receipts (excluding those from the Federal Reserve System) for the 2002-2011 period.

Expiring Tax Provisions

CBO's projections of revenues rest on the assumption that current tax laws remain unaltered except for scheduled changes and expirations, both of which occur on time. (The sole exception to that approach is the expiration of excise taxes dedicated to trust funds, which under budget rules are included in the revenue projections whether or not they are scheduled to expire.) Yet expiring tax provisions can have

a significant effect on CBO's estimates—even in ordinary circumstances, when they do not include provisions such as the EGTRRA tax cuts, which are due to expire in 2010. Many expiring provisions are extended almost as a matter of course, and most of them reduce receipts; thus, if CBO incorporated the provisions' effects in its projections, those estimates of revenues would be lower than the revenues projected under current law. Because the EGTRRA tax cuts are included as expiring provisions, the size of that category in CBO's current projections is substantially larger than in most past years.

Provisions That Expired in 2001

Twelve tax provisions expired in late 2001, and all of them acted to reduce revenues (see Table 3-12). The House included at least partial extensions of 10 of the provisions in the Economic Security and Worker Assistance Act of 2001, which was passed in December, although the legislation and extensions did not become law. The remaining measures—the Andean Trade Preference Initiative and the Generalized System of Preferences—were considered in separate legislation.

Sometimes in the past, when provisions have recently expired, the Congress has subsequently extended them either prospectively or retroactively. If all of those expired provisions were immediately and permanently extended, they would reduce revenues by a total of $93 billion over the 2003-2012 period. Over the same period, about $51 billion, or more than half of the total cost of extending those expired provisions, would come from the measure that allows taxpayers to claim certain personal credits against the alternative minimum tax. Without the extension of that provision, some taxpayers would be unable to claim the education tax credits that were enacted in the Taxpayer Relief Act of 1997. The provision allowing an exemption from taxable income for certain passive income from financial activities abroad would reduce revenues by an estimated $27 billion over the projection period if it was extended at least through 2012.

Provisions Expiring During the 2002-2012 Period

A number of additional provisions will expire during the period from 2002 through 2012. The most significant of them, from an overall budgetary perspective, were enacted in EGTRRA.[7] Three provisions from that law expire by the end of 2006, and the rest, representing the bulk of the law's budgetary effects, expire on December 31, 2010. If those measures were extended, CBO and the Joint Committee on Taxation (JCT) project that revenues would be reduced by $569 billion through 2012. Most of that reduction, or $430 billion, would be felt at the end of the period, in 2011 and 2012, as a result of extending the tax cuts that expired at the end of 2010. Those reductions include the cuts in marginal tax rates for individuals, increases in the child tax credit, and repeal of the estate tax.

About $140 billion of the loss in revenues from extending the expiring provisions of EGTRRA would occur earlier than in 2011. Extending the changes to estate and gift taxes, which expire at the end of 2010, could reduce revenues as early as 2003, because if taxpayers knew that the law's repeal of the estate tax would become permanent in 2011, some might postpone taxable gifts that they would otherwise have made during the decade. In addition, CBO's and JCT's estimates of the effects of extending EGTRRA's provisions also incorporate the assumption that the higher exemption levels for the AMT, which expire in 2004, are extended at their 2004 levels. Under that assumption, the exemption levels would not rise with inflation, so a growing number of taxpayers would still become subject to the AMT over time—albeit fewer than if the higher exemption levels expired as they are now scheduled to do. Two other provisions of EGTRRA expire before 2010—the deduction for qualified education expenses (in 2005) and the credit for elective deferrals and contributions to individual retirement accounts (in 2006).

7. For a discussion of the likely economic effects of EGTRRA, see Congressional Budget Office, *The Budget and Economic Outlook: An Update* (August 2001), Box 2-3, pp. 34-35.

Table 3-12.
Effect of Extending Tax Provisions That Will Expire Before 2012 (In billions of dollars)

Tax Provision	Expiration Date	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Provisions That Expired in 2001														
Generalized System of Preferences	09/30/2001	-0.3	-0.4	-0.4	-0.5	-0.5	-0.6	-0.6	-0.7	-0.7	-0.8	-0.8	-2.4	-6.0
Andean Trade Preference Initiative	12/04/2001	*	*	*	*	*	*	*	*	*	*	*	-0.1	-0.3
Credit for Electric Vehicles	12/31/2001	*	*	*	*	*	*	*	*	*	*	*	*	-0.1
Credit for Electricity Production from Renewable Sources	12/31/2001	*	*	-0.1	-0.1	-0.2	-0.2	-0.2	-0.3	-0.3	-0.3	-0.3	-0.6	-2.0
Deductions for Clean Fuel Vehicles and Refueling Property	12/31/2001	*	*	*	*	*	*	*	*	*	*	*	-0.2	-0.3
Net Income Limitation for Marginal Oil and Gas Wells	12/31/2001	*	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.2	-0.5
Qualified Zone Academy Bonds	12/31/2001	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands	12/31/2001	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.7
Subpart F for Active Financing Income	12/31/2001	-0.3	-1.5	-1.7	-1.9	-2.1	-2.4	-2.7	-3.1	-3.5	-4.0	-4.4	-9.6	-27.1
Treatment of Nonrefundable Personal Credits Under the AMT	12/31/2001	-0.1	-0.7	-1.0	-1.7	-3.8	-4.7	-5.4	-6.2	-6.8	-8.3	-12.4	-11.8	-50.9
Welfare-to-Work Credit	12/31/2001	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.5	-1.2
Work Opportunity Credit	12/31/2001	-0.1	-0.2	-0.3	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-0.4	-1.8	-3.8
Provisions Expiring in 2002 and 2003														
Archer Medical Savings Accounts	12/31/2002	n.a.	*	*	*	*	*	*	*	*	*	*	*	-0.1
Luxury Tax on Passenger Vehicles	12/31/2002	n.a.	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	1.1	2.3
IRS User Fees	10/01/2003	n.a.	n.a.	**	**	**	**	**	**	**	**	**	0.1	0.3
Tax Return Information for Veterans' Payments	10/01/2003	n.a.	n.a.	**	**	**	**	**	**	**	**	**	0.1	0.2
Brownfields Environmental Remediation	12/31/2003	n.a.	**	-0.1	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-0.3	-1.0	-2.6
Corporate Contributions of Computers to Schools	12/31/2003	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.5	-1.3
Depreciation for Business Property on Indian Reservations	12/31/2003	n.a.	**	-0.1	-0.4	-0.6	-0.6	-0.5	-0.4	-0.3	-0.3	-0.3	-1.7	-3.5
Indian Employment Tax Credit	12/31/2003	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1	-0.3
Tax Incentives for Investment in the District of Columbia	12/31/2003	n.a.	n.a.	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.3	-0.3	-0.4	-0.4	-1.7

(Continued)

Table 3-12.
(Continued)

Tax Provision	Expiration Date	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	Total, 2003-2007	Total, 2003-2012
Provisions Expiring After 2003 and Before 2012														
Credit for Research and Experimentation	06/30/2004	n.a.	n.a.	-0.6	-3.7	-4.8	-5.8	-6.7	-7.4	-7.9	-8.4	-8.9	-14.9	-54.2
Abandoned-Mine Reclamation Fees	09/30/2004	n.a.	n.a.	n.a.	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.7	2.0
Increased AMT Exemption Amount	12/31/2004	n.a.	n.a.	n.a.	-3.7	-11.2	-15.6	-19.9	-24.0	-26.7	-23.3	-14.9	-30.5	-139.4
Depreciation of Clean-Fuel Automobiles	12/31/2004	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1
Authority for Undercover Operations	12/31/2005	n.a.	n.a.	n.a.	n.a.	**	**	**	**	**	**	**	**	**
Deduction for Qualified Education Expenses	12/31/2005	n.a.	n.a.	n.a.	n.a.	-2.2	-3.0	-3.1	-3.2	-3.2	-3.2	-3.3	-5.2	-21.2
Puerto Rico Business Credits	12/31/2005	n.a.	n.a.	n.a.	n.a.	-0.6	-1.5	-1.7	-1.8	-1.9	-2.1	-2.2	-2.1	-11.9
Transfer of Excess Assets in Defined-Benefit Plans	12/31/2005	n.a.	n.a.	n.a.	n.a.	**	**	**	**	**	**	0.1	0.1	0.3
Credit for IRA and 401(k)-Type Plans	12/31/2006	n.a.	n.a.	n.a.	n.a.	n.a.	-0.7	-1.4	-1.2	-1.1	-1.0	-1.0	-0.7	-6.4
FUTA Surtax of 0.2 Percentage Points	12/31/2007	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	0	0	0	0	n.a.	0
New Markets Tax Credit	12/31/2007	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.1	-0.3	-0.4	-0.6	-0.8	n.a.	-2.3
Empowerment and Renewal Zones	12/31/2009	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.9	-1.7	-1.6	n.a.	-4.2
General Expiration of EGTRRA Provisions	12/31/2010	n.a.	-1.2	-1.5	-1.8	-2.3	-2.5	-2.7	-2.8	-4.0	-126.7	-229.0	-9.2	-374.4
All Expiring Provisions[a]														
Total		-1.0	-4.0	-6.0	-14.6	-29.1	-38.3	-46.0	-52.2	-58.9	-188.5	-297.1	-92.0	-734.7

SOURCES: Joint Committee on Taxation, Congressional Budget Office.

NOTES: AMT = alternative minimum tax; IRS = Internal Revenue Service; IRA = individual retirement account; FUTA = Federal Unemployment Tax Act; EGTRRA = Economic Growth and Tax Relief Reconciliation Act of 2001; n.a. = not applicable.

* = loss of less than $50 million.

** = gain of less than $50 million.

a. The overall totals do not equal the sums of the separate provisions because they include estimated interactions among provisions in 2011 and 2012. Those interactions would occur if all of the provisions were extended together.

Eighteen provisions not related to EGTRRA also expire over the 2002-2012 period, and 11 of them, if extended, would reduce revenues. The one with the greatest effect by far is the research and experimentation tax credit, which was first enacted in 1981. In 1999, the Congress extended that tax benefit through June 2004, the ninth and longest time it has been extended since 1985. Extending the credit from 2005 through 2012 would reduce revenues by about $54 billion. In all, extending those 11 provisions would decrease receipts by $82 billion through 2012.

Six provisions that expire between 2002 and 2005 would raise revenues if they were extended. Extending the provision imposing fees for the reclamation of abandoned mines and the luxury tax on passenger vehicles would each raise between roughly $200 million and $250 million per year; each of the four other provisions would raise revenues by less than $50 million annually. Those other measures include extending user fees charged by the Internal Revenue Service (IRS), allowing employers to transfer excess assets in defined-benefit plans to a special account dedicated to health benefits for retirees, and providing information to the IRS on government benefits received by veterans.

One expiring provision has no effect on revenues. The Federal Unemployment Tax Act surcharge brings in about $2 billion a year; however, the additional revenues from extending the provision would be rebated to the states. CBO expects that the states would use them to lower their unemployment insurance tax rates. Since receipts from the state taxes are counted as federal unemployment tax receipts, extending the surcharge would have no net effect on revenues.

Expiring Provisions That Are Included in the Baseline

In its projections, CBO takes into account excise tax receipts earmarked for trust funds, even if provisions for those taxes are scheduled to expire. The largest of such taxes that are slated to expire during the next decade finance the Highway Trust Fund. Some of the taxes for that fund are permanent, but most of them expire on September 30, 2005. Extending them at today's rates contributes about $45 billion to CBO's revenue projections in 2012, or about half of total excise tax receipts.

Other expiring trust fund taxes, if extended, would account for smaller amounts in 2012, CBO estimates. Taxes dedicated to the Airport and Airways Trust Fund, which are scheduled to expire at the end of 2007, would contribute about $16 billion to revenues in 2012. Taxes for the Leaking Underground Storage Tank Trust Fund, set to expire on March 31, 2005, would contribute about $250 million. No other expiring tax provisions are automatically extended in CBO's projections.

Total Effect of Expiring Provisions

If all expiring tax provisions were extended together, projections of total revenues would be lower by $4 billion in 2003, with revenue losses growing to $59 billion in 2010 before jumping to $189 billion in 2011 and $297 billion in 2012. Over the 2003-2012 period, revenues would be reduced by $735 billion. That estimate of the effects of jointly extending the expiring provisions includes interactions among the provisions, which reduce revenues by an additional $23 billion in 2011 and 2012.