CHAPTER IV

EFFECTS ON EXCISE TAXES AND TRUST FUNDS

The Omnibus Budget Reconciliation Act of 1993, by increasing tax rates on transportation fuels and expanding coverage of the Hospital Insurance payroll tax, affects the balances of trust funds that finance federal transportation programs and Medicare. The increased revenues from excise taxes on transportation fuels go partly to the general fund and partly to the Highway Trust Fund (HTF). The increased revenues from the HI payroll tax go to the HI (Medicare) trust fund. The HI trust fund also receives additional revenues from the OBRA-93 increase in taxation of Social Security benefits.

TAXES ON TRANSPORTATION FUELS

OBRA-93 increases taxes on transportation fuels. It also changes the allocation of revenue from these taxes between trust funds for specific uses and the general fund.

Taxes and Trust Funds Before OBRA-93

Under prior law, most transportation fuels were subject to tax. Most of the revenue from transportation taxes went to trust funds that finance highway spending and other federal transportation programs. Some of the revenues also went to trust funds for other purposes and to the general fund.

The tax rates on transportation fuels in 1993 were as follows: 14.1 cents per gallon on gasoline used as a highway fuel, in small engines (for example, in lawn mowers and snow blowers), in vehicles that use recreational trails, or in recreational motorboats; 20.1 cents per gallon on diesel used as a highway fuel; 15.1 cents per gallon on gasoline and 17.6 cents per gallon on jet fuel used in noncommercial aviation; 17.1 cents per gallon on diesel fuel used in barges traveling on inland or intracoastal waterways;[1] and 0.1 cents per gallon on fuels used in commercial aviation (see Table 9). In addition, there were special tax rates on some alternative highway fuels.

1. This rate was scheduled to increase to 19.1 cents per gallon for calendar year 1994 and to 20.1 cents per gallon for calendar year 1995 and thereafter.

TABLE 9. FUEL TAX RATES UNDER PRIOR LAW AND UNDER OBRA-93
(In cents per gallon)

Fuel	Tax Rate Under Prior Law: Through Sept. 30, 1995	Tax Rate Under Prior Law: After Sept. 30, 1995[a]	OBRA-93 Tax Rate[a]
Gasoline (Highway use, small engine use, recreational trails use, and noncommercial motorboat use)	14.1	11.6	18.4
Noncommercial Aviation Gasoline	15.1	15.1	19.4
Gasohol	8.7	6.2	13.0
Diesel (Highway use, small engine uses, and recreational trails use)	20.1	17.6	24.4
Noncommercial Motorboat Diesel	0	0	24.4
Commercial Aviation Jet Fuel[b]	0.1	0.1	4.4
Railroad Diesel[c]	2.6	0.1	5.65
Noncommercial Aviation Jet Fuel	17.6	17.6	21.9
Inland Waterway Diesel			
Jan. 1, 1993, through Dec. 31, 1993	17.1	17.1	n.a.
Oct. 1, 1993, through Dec. 31, 1993	n.a.	n.a.	21.4
Jan. 1, 1994, through Dec. 31, 1994	19.1	19.1	23.4
After Dec. 31, 1994	20.1	20.1	24.4
Liquid Petroleum Gas	14.0	11.5	18.3
Compressed Natural Gas	0	0	4.3

SOURCE: Congressional Budget Office.

NOTES: Tax rates include the 0.1 cent per gallon leaking underground storage tank (LUST) tax.
OBRA-93 = Omnibus Budget Reconciliation Act of 1993.

a. These tax rates become effective on October 1, 1993, for all fuels except noncommercial motorboat diesel, which becomes taxable on January 1, 1994. The LUST tax rate and the Airport and Airway Trust Fund financing rates are scheduled to expire after December 31, 1995. The Highway Trust Fund financing rates are scheduled to expire after September 30, 1999. The tax on noncommercial motorboat diesel is scheduled to expire December 31, 1999.

b. Commercial aviation fuel is exempt from the 4.3 cents per gallon excise tax from October 1, 1993, through September 30, 1995.

c. The OBRA-93 tax rate applies beginning October 1, 1995. The applicable tax for October 1, 1993, through September 30, 1995, is 6.9 cents per gallon.

Tax revenue from these sources financed spending from the Highway Trust Fund, the Airport and Airway Trust Fund, the Leaking Underground Storage Tank (LUST) Trust Fund, the Aquatic Resources Trust Fund, the National Recreational Trails Trust Fund, the Inland Waterway Trust Fund, and the Land and Water Conservation Fund (see Figure 2). The Omnibus Budget Reconciliation Act of 1990 allocated 2.5 cents per gallon from the taxes on gasoline (other than aviation gasoline) and diesel fuel to the general fund for the first time. Before OBRA-93, the 2.5-cent portion of the gasoline and diesel fuel tax rates that provided revenues for the general fund was scheduled to expire on September 30, 1995.

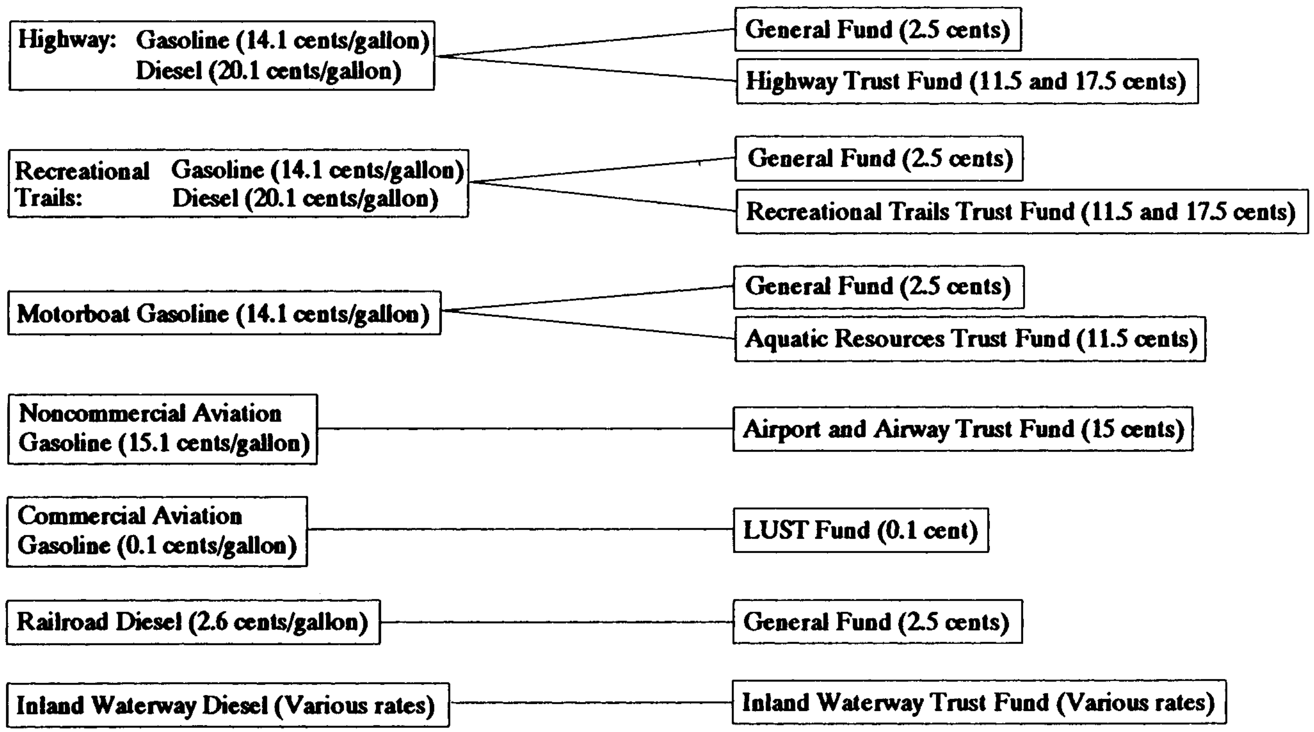
Tax Rate Increases

OBRA-93 increases taxes on transportation fuels, extends the 2.5 cents per gallon portion of the tax on fuels, and taxes noncommercial (recreational) uses of diesel fuel for the first time. It raises the tax rate on most transportation fuels by 4.3 cents per gallon, beginning October 1, 1993 (see Table 9). The 4.3 cents tax rate increase applies to gasoline, diesel, and liquid petroleum gas used as a highway fuel; gasoline and diesel used for off-highway nonbusiness use; gasoline and diesel used in recreational motorboats; fuel used in commercial and noncommercial aviation; diesel used by railroads; and diesel used on inland and intracoastal waterways. The tax rate increases also apply to alternative highway fuels, including gasohol. Fuel used in commercial airline transportation is exempt from the tax until October 1, 1995.

OBRA-93 extends until September 30, 1999, the 2.5-cent portion of the tax on some transportation fuels (primarily highway and recreational motorboat uses of gasoline and highway and railroad uses of diesel fuel). These taxes currently provide revenues for the general fund. The 2.5 cents per gallon tax on railroad diesel becomes 1.25 cents per gallon after September 30, 1995. Before OBRA-93, this portion of the tax on fuels was scheduled to expire on September 30, 1995.

OBRA-93 also imposes a new tax of 24.4 cents per gallon on diesel fuel used in noncommercial motorboats, beginning January 1, 1994. This provision taxes diesel fuel used in noncommercial motorboats for the first time at the same rate as the tax on diesel in other uses. The tax is scheduled to expire after December 31, 1999.

Figure 2.
Flow of Funds from Transportation Fuels Taxes Before OBRA-93



SOURCE: Congressional Budget Office based on the Internal Revenue Code.

NOTES: The allocation of the 0.1 cent per gallon tax to the Leaking Underground Storage Tank (LUST) Trust Fund is not depicted above, except in the case of commercial aviation gasoline.

OBRA-93 = Omnibus Budget Reconciliation Act of 1993.

Allocation to Trust Funds

OBRA-93 allocates the additional revenue from the 4.3 cents per gallon tax increase on transportation fuels to the general fund (see Figures 2 and 3). Revenue from the new tax on diesel fuel in noncommercial motorboats will also be retained in the general fund.

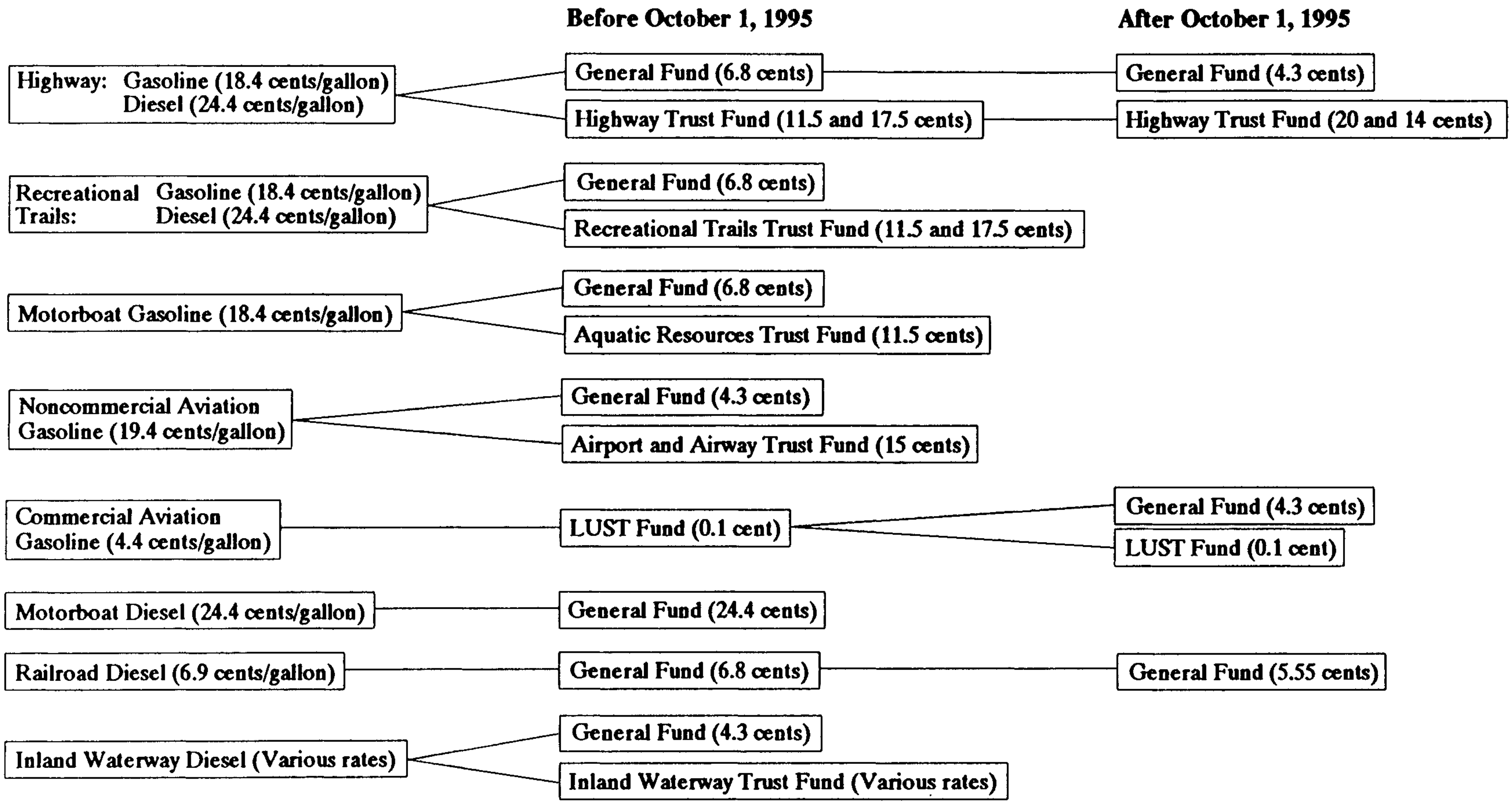
Although OBRA-93 allocates new tax revenues to the general fund, it also increases funding for the Highway Trust Fund. It does this by allocating to the HTF most of the revenue from extending the 2.5 cents per gallon portion of the tax beyond September 30, 1995. Under prior law, the revenues from this tax went to the general fund. After September 30, 1995, the only revenue from this tax that will remain in the general fund will be the amount attributable to noncommercial motorboats, small engines, recreational trails, and railroad fuel uses. The remainder of revenues (about 97 percent) will go to the HTF.

The transfer of revenues to the HTF from extending the 2.5 cents portion of the transportation fuels taxes will provide sufficient funds to finance the spending that the Congress authorized in the Intermodal Surface Transportation Efficiency Act of 1991 (ISTEA). Since enacting ISTEA, the Congress has limited obligations below authorized levels. If the Congress sets obligation limitations that are consistent with the spending levels that ISTEA authorized, highway spending will increase. But highway spending is discretionary, and total discretionary spending is subject to the annual caps imposed under the Budget Enforcement Act of 1990. Consequently, the additional highway spending will require offsetting cuts in other discretionary spending.

Changes in Tax Administration

To improve compliance, OBRA-93 places the tax collection point for diesel fuel at the distributor, the same collection point as the gasoline tax, beginning January 1, 1994. Under prior law, the Internal Revenue Service (IRS) collected the diesel fuel tax at the final-distributor level because diesel fuel for transportation is physically indistinguishable from exempt home heating oil.

Figure 3.
Flow of Funds from Transportation Fuels Taxes After OBRA-93



SOURCE: Congressional Budget Office based on the Internal Revenue Code as amended by OBRA-93.

NOTES: The allocation of the 0.1 cent per gallon tax to the Leaking Underground Storage Tank (LUST) Trust Fund is not depicted above, except in the case of commercial aviation gasoline. The LUST tax rate expires December 31, 1995.

OBRA-93 = Omnibus Budget Reconciliation Act of 1993.

Instead, OBRA-93 requires taxpayers to dye untaxed diesel fuel before it leaves the terminal.[2] Vendors or purchasers who are exempt users or who use undyed (taxed) fuel for an exempt purpose may apply for a refund of the tax from the IRS.

Effects on Consumers

Under prior law, CBO projected the gasoline price to be \$1.24 per gallon in 1994. The 4.3 cents per gallon increase in the tax rate will raise the 1994 gasoline price by about 3 percent. CBO estimates that the tax increase will reduce the consumption of motor gasoline by less than 1 percent.

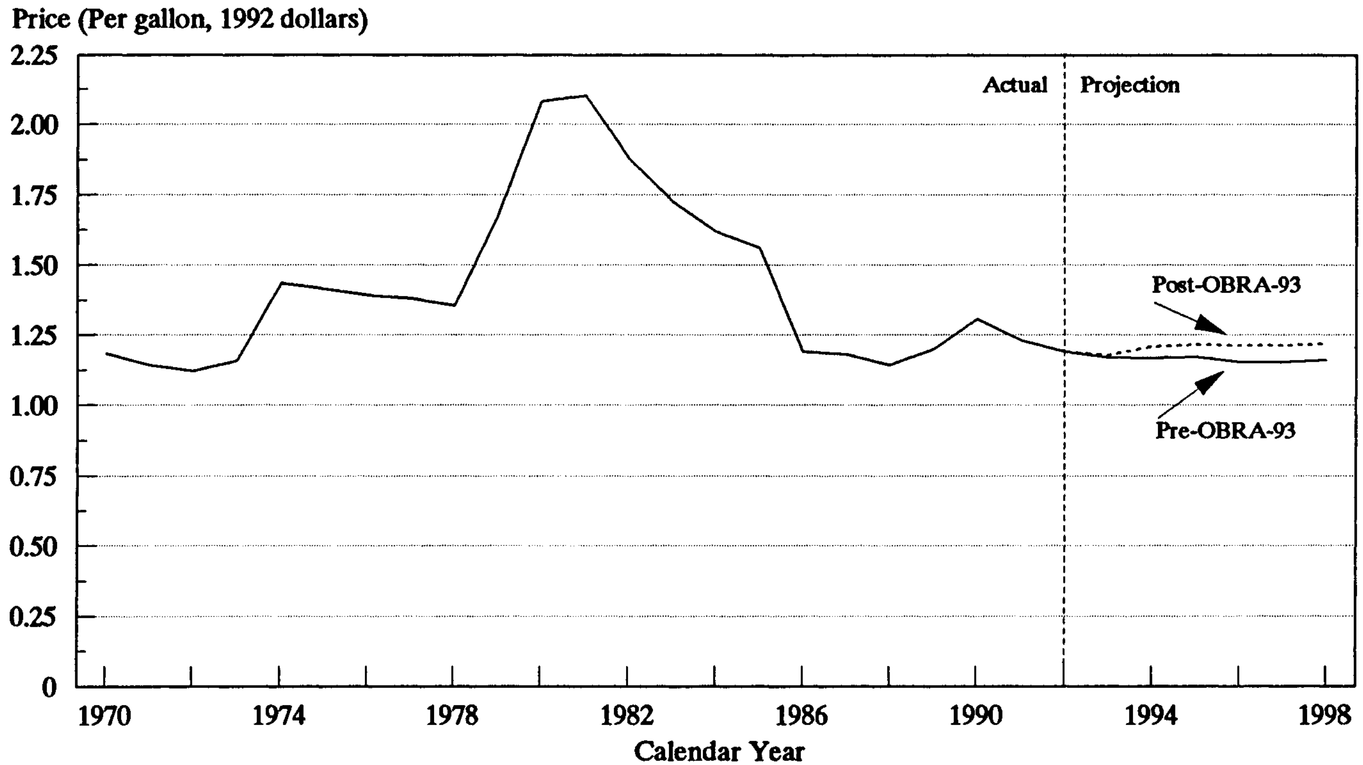
The tax increase will leave the price of gasoline in constant dollars about equal to its level before the 1973 oil embargo and significantly below levels reached in the late 1970s and early 1980s (see Figure 4). It will also leave average U.S. tax rates for gasoline and diesel fuel significantly below tax rates in other countries of the Organization for Economic Cooperation and Development (see Table 10).

CBO estimates that the 4.3 cents per gallon increase in the tax on transportation fuels will raise an average urban household's annual cost of purchasing motor fuels by about \$45. This figure includes both the increased cost of direct household motor fuel purchases and the increased cost of other goods resulting from higher transportation costs in the business sector. It includes an offset for the effect of higher consumer prices on indexed transfer programs and on individual income tax exemptions, deductions, and brackets.

The impact of the tax increase will vary among households depending on how many miles they drive, the road congestion conditions that they face, and the fuel efficiency of their vehicles. Because these factors, especially driving distances, vary among regions, the impact of the tax will differ in different parts of the country. But differences among urban regions will not be large. The average urban household in the Northeast and Midwest spends slightly less than the national average on motor fuels; the average urban household in the South and West spends virtually the same as the national average. (Urban households account for about 85 percent of the U.S.

2. This provision is designed to work in conjunction with the requirement in the Clean Air Act Amendments of 1990 specifying that, beginning October 1, 1993, off-highway diesel fuel with a sulphur content in excess of 0.05 percent by weight be dyed.

Figure 4.
Real Average Retail Prices of Gasoline Before and After Incorporating the Effects of OBRA-93



SOURCE: Congressional Budget Office.

NOTES: Retail prices include state and federal taxes.
OBRA-93 = Omnibus Budget Reconciliation Act of 1993.

TABLE 10. MOTOR FUEL TAX RATES FOR SELECTED COUNTRIES AS OF AUGUST 1, 1993 (In U.S. dollars per gallon)

Country	Gasoline	Diesel
Belgium	2.12	1.40
Canada[a]	0.78	0.63
France	2.21	1.22
Germany	2.14	1.31
Italy	2.36	1.65
Japan	2.04	0.98
Netherlands	2.40	1.10
United Kingdom	1.71	1.45
United States[b]	0.33	0.39

SOURCE: Congressional Budget Office based on Department of Transportation, Federal Highway Administration, "Monthly Motor Fuel Reported by States" (April 1993); Organization for Economic Cooperation and Development, "Energy Prices and Taxes" (First Quarter 1993).

NOTE: Rates were converted to U.S. currency using current exchange rates. The source for foreign tax rates was data collected by the U.S. Department of Energy.

a. Canadian tax rates are for the first quarter of 1993.

b. Includes the weighted average of state tax rates and federal tax rates.

population.) Differences between rural and urban households are larger, however. The average rural household spends about 20 percent more than the national average on highway motor fuels.[3]

PAYROLL TAXES AND THE HOSPITAL INSURANCE TRUST FUND

Before the enactment of OBRA-93, CBO estimated that the Hospital Insurance Medicare trust fund would be depleted by 1999. OBRA-93 increases revenues for the HI trust fund and enacts outlay savings in the Medicare program. These tax and spending changes delay the projected depletion of the trust fund until 2003. Higher revenues account for two-thirds of the improvement in the trust fund's balance between 1994 and 1998. The vast majority of the new revenues for the HI trust fund derive from two provisions:

3. For a fuller discussion of the regional impacts of alternative energy taxes, see statement of Robert D. Reischauer, Director, Congressional Budget Office, before the Senate Committee on Energy and Natural Resources, February 24, 1993.

eliminating the HI taxable earnings cap and increasing the taxation of Social Security benefits.

OBRA-93 eliminates the maximum taxable earnings cap for HI Medicare taxes beginning January 1, 1994. (The cap on the amount of wages subject to the tax was $135,000 in 1993 and was indexed to the growth rate of the Social Security wage base.) This provision increases HI taxes for fewer than 3 million workers, or about 2 percent of the work force.

Before OBRA-93, the cap made the HI tax regressive at the top of the income distribution because workers earning more than the maximum level of taxable earnings paid a smaller share of their income in payroll taxes than other workers. Eliminating the cap removes this regressive feature of the tax and makes it strictly proportional to wages. One can argue, however, that the tax should not rise much with income because it finances Medicare benefits that do not rise either with income or with taxes paid. Eliminating the maximum taxable earnings cap raises the subsidy that high-wage workers pay to other workers to finance their future Medicare benefits.

OBRA-93 increased the amount of Social Security and Railroad Retirement (Tier I) benefits subject to income taxes. Before OBRA-93, adjusted gross income included the lesser of one-half of Social Security and Tier I benefits or one-half of the excess of the taxpayer's combined income (AGI plus nontaxable interest income plus one-half of Social Security and Tier I benefits) over a threshold amount. The threshold amount was $25,000 for single returns and $32,000 for joint returns.

OBRA-93 establishes an additional threshold amount at which the lesser of 85 percent of Social Security and Tier I benefits or 85 percent of the excess of the taxpayer's combined income is included in AGI. The new threshold amount is $34,000 for single returns and $44,000 for joint returns. Including 85 percent of benefits in AGI makes the tax treatment of Social Security for workers with high earnings roughly comparable to that of contributory retirement plans in the private sector. The tax treatment of Social Security benefits remains more generous than contributory plans for those with relatively low earnings.

OBRA-93 allocates the revenue from taxing Social Security benefits to two different trust funds. Revenues from the pre-OBRA-93 taxes continue to be allocated to the Social Security (OASDI) trust fund. But revenues from the additional taxes imposed by OBRA-93 will be transferred to the HI trust fund.

The reduction in HI Medicare spending comes mainly from reduced payments to hospitals, physicians, and other health care providers. The largest provision reduces the annual indexing factor used to calculate the reimbursements to hospitals under the prospective payment system.

CHAPTER V

CONCLUSIONS

The Omnibus Budget Reconciliation Act of 1993 reduces the federal deficit by $433 billion between 1994 and 1998 compared with the Congressional Budget Office baseline. The revenue provisions of the act account for more than half of the reduction in the deficit.

The tax provisions in OBRA-93 increase the tax burden on the highest income taxpayers, while reducing taxes on average for low-income families. The increase in marginal tax rates on the highest income taxpayers reduces their incentives to work and save and increases their incentive to participate in tax-favored activities. OBRA-93 expands and extends some existing tax preferences, introduces some new ones, and reduces or eliminates others. The changes in tax rates and in more narrow provisions affect the allocation of investment among industries and locations, the choice of business organizational form and firm size, and some employment and consumption choices.

OBRA-93 increases taxes on high-income taxpayers by adding two new marginal tax rate brackets, increasing the rate of the individual alternative minimum tax, extending the provisions of current law that limit itemized deductions and phase out personal exemptions for high-income taxpayers, and removing the cap on wages subject to the Hospital Insurance payroll tax. At the same time, OBRA-93 reduces taxes on low-income families by expanding the earned income tax credit. Taxes on middle-income families increase, but only slightly.

OBRA-93 also redistributes the tax burden among types of families. On average, taxes on families with children increase slightly less than those on other families, largely because of the expansion of the EITC. Taxes increase slightly more on families with an elderly head than on other families, largely because of the provision that increases the taxation of Social Security benefits.

The higher marginal tax rates and the changes in the EITC also affect how the tax law treats families with similar incomes but different circumstances. The expansion of the EITC increases marriage penalties for some low-income families with children. The higher marginal tax rates increase both marriage penalties and marriage bonuses for high-income people, with the effect depending on their total income and the share of earned income received by each spouse. The higher marginal tax rates also increase the tax penalty that graduated rates impose on people whose incomes vary from year to year.

The higher marginal tax rates on high-income taxpayers in OBRA-93 reduce incentives to work and save and increase incentives to take compensation in the form of tax-free fringe benefits, spend money on tax-deductible goods and services, and shift saving to tax-exempt and tax-preferred assets. OBRA-93 also changes marginal rates for low-income taxpayers by increasing the subsidy rate of the EITC and raising both the rate and the income level at which the subsidy phases out. Marginal tax rates increase for some low-income workers and decrease for others; on average, marginal rates on earned income in the bottom quintile increase slightly. Middle-income taxpayers experience much smaller changes in marginal tax rates than either high- or low-income taxpayers.

The higher tax rates will reduce private saving, offsetting some of the increase in national saving from the lower federal deficit. The tax increases can affect private saving both by reducing the total after-tax income of high-income families and by reducing the after-tax rate of return they receive from new saving. Economists do not agree, however, on whether the lower after-tax returns will reduce saving and, if so, by how much. CBO estimates that the two effects combined will lower private saving by between $5 billion and $7 billion per year.

OBRA-93 influences many business decisions. Provisions in the law encourage Subchapter S corporations to switch back to the C corporate form, encourage investment and employment in small businesses, discourage some international transactions, and discourage investment in U.S. possessions by capital-intensive corporations, although without necessarily reducing employment in possessions. Other provisions have little behavioral effect. These include provisions that affect past transactions, such as the restriction on tax benefits for firms that purchased insolvent savings and loans, and provisions that alter effective tax rates only slightly, such as the speedup in corporate estimated tax payments.

The higher marginal tax rates in OBRA-93 do not place small businesses at a disadvantage compared with large corporations. Although some investors in, and employees of, small businesses will face higher marginal tax rates, they would pay the same rates if they received an equal income from other assets or employers. Moreover, most small business people do not face higher marginal tax rates under OBRA-93, and most taxpayers whose marginal tax rates increase do not receive the majority of their income from small business activities.

Tax expenditures are the revenue losses from provisions of the tax law that provide selective relief for groups of taxpayers or special incentives for particular economic activities. OBRA-93 extends some tax expenditure provisions, introduces some new tax expenditures, and limits others. On balance, however, OBRA-93 increases tax expenditures because the higher marginal rates it imposes raise the value of provisions that convey selective tax relief. The higher rates significantly increase the value of tax preferences that primarily benefit high-income individuals, but only slightly increase the value of preferences that corporations and a broader group of individuals claim.

OBRA-93 increases tax rates on gasoline and other transportation fuels. It increases the tax rates on most consumption of these fuels by 4.3 cents per gallon and also extends through September 30, 1999, the 2.5-cent portion of the tax that was scheduled to expire on September 30, 1995. CBO estimates that the 4.3 cents per gallon tax increase will raise the average household's annual cost of purchasing motor fuels by only $45 and reduce consumption by less than 1 percent. Even with this increase, the price of gasoline in constant dollars will remain about the same as before the 1973 oil embargo and will continue to be much lower than the price in other countries belonging to the Organization for Economic Cooperation and Development.

OBRA-93 also reallocates revenues among the general fund and special trust funds. The 4.3-cent tax increase will go to the general fund, in contrast to the historical practice until 1990 of allocating all gasoline tax revenues to the Highway Trust Fund. The 2.5-cent portion of the tax that now goes to the general fund, however, will be reallocated to the HTF after October 1, 1995. OBRA-93 also significantly increases funding for the Medicare's Hospital Insurance Trust Fund. It does that by increasing revenues from the HI payroll tax, allocating revenues from the increased taxation of Social Security benefits to the fund, and reducing HI (Medicare) spending.