CHAPTER

4

The Revenue Outlook

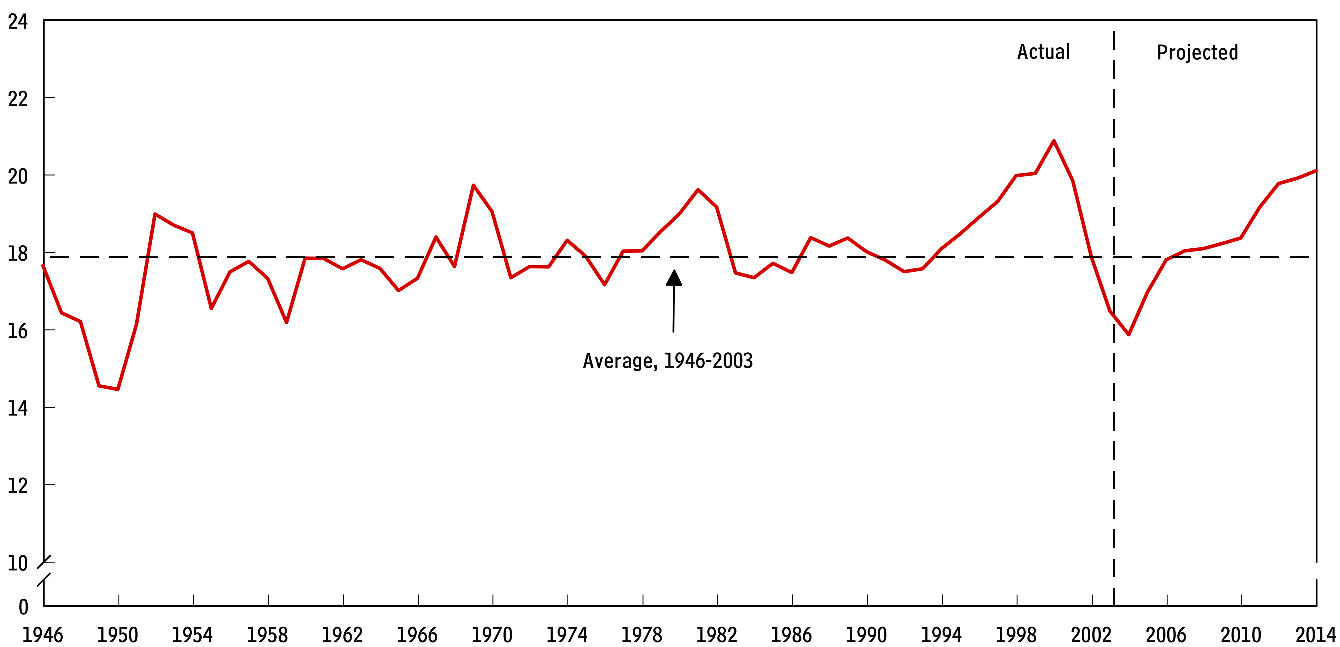
If current policies remain unchanged, the Congressional Budget Office estimates that federal revenues will reach $1,817 billion in 2004. That amount is about $35 billion (or 2 percent) more than revenues in 2003—but still below the amounts collected from 1999 to 2002. As a share of gross domestic product, revenues are expected to equal 15.8 percent this year, lower than in any year since 1950 *(see Figure 4-1).*

Over the coming decade, receipts are projected to rise again, growing faster than GDP in each year after 2004 *(see Figure 4-2).* That ascent is driven mainly by the structure of the tax system, which claims a higher fraction of income in taxes as income grows. The trend of rising receipts is expected to be especially pronounced—first in 2005 and 2006, and then again in 2011—as the tax cuts enacted from 2001 through 2003 expire.

Figure 4-1.

Total Revenues as a Share of GDP, 1946 to 2014

(Percentage of GDP)

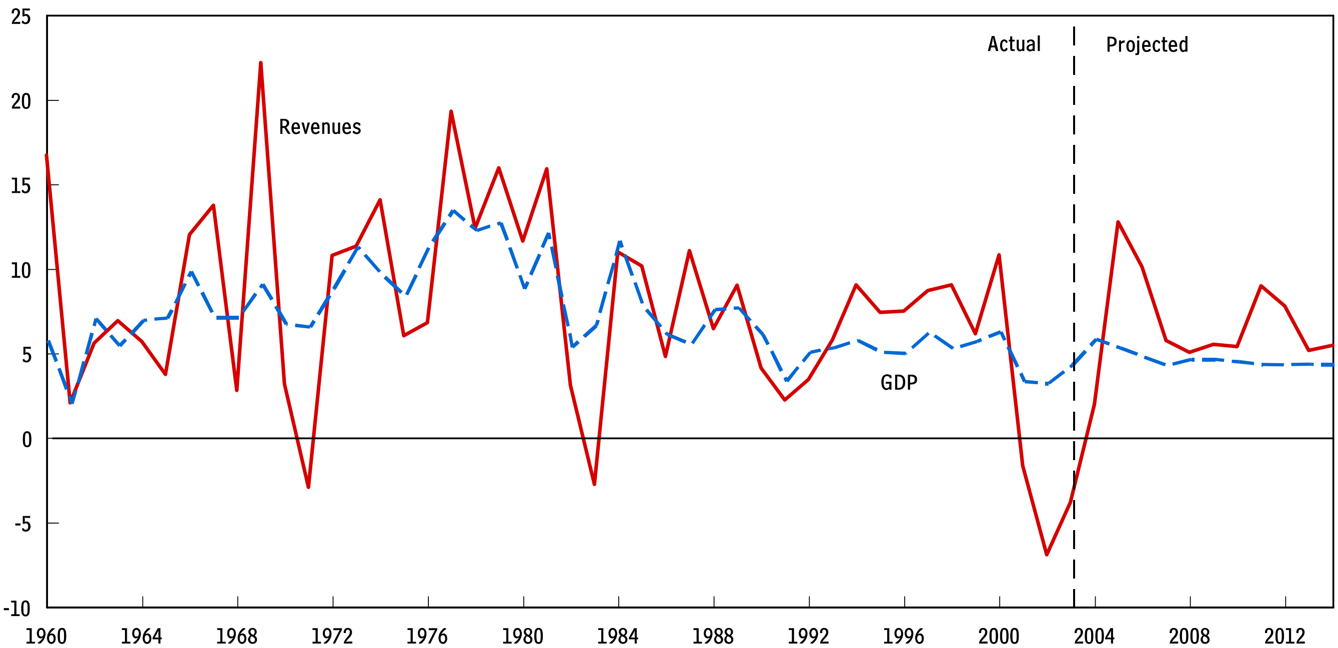


Source: Congressional Budget Office.

Figure 4-2.

Annual Growth of Federal Revenues and GDP, 1960 to 2014

(Percentage change from previous year)



Source: Congressional Budget Office.

CBO's current revenue projections are 3 percent lower, on average, than those it published in August 2003. CBO is now projecting a total of $790 billion less in receipts for the 2004-2013 period than it did last summer. Roughly four-fifths of that reduction stems from changes in CBO's economic forecast, which tend to reduce receipts after 2006 primarily because of lower projected inflation. The remaining reduction can be traced to reestimates of the receipts that would flow from a given level of overall economic activity.

Revenues by Source

Federal revenues come from various sources: individual income taxes, social insurance (payroll) taxes, corporate income taxes, excise taxes, estate and gift taxes, customs duties, and miscellaneous receipts. In recent years, individual income taxes have typically produced nearly half of all revenues and claimed between 8 percent and 10 percent of GDP *(see Figure 4-3).* Social insurance taxes (mainly for Social Security and Medicare's Hospital Insurance) are the second largest source of receipts. They generate approximately a third of federal revenues and amount to a little less than 7 percent of GDP. Corporate income taxes contribute about one-tenth of overall revenues and have usually represented between 1.5 percent and 2 percent of GDP. Revenues from other taxes, duties, and miscellaneous receipts (including profits from the Federal Reserve System) make up the balance and together constitute about 1.5 percent of GDP.

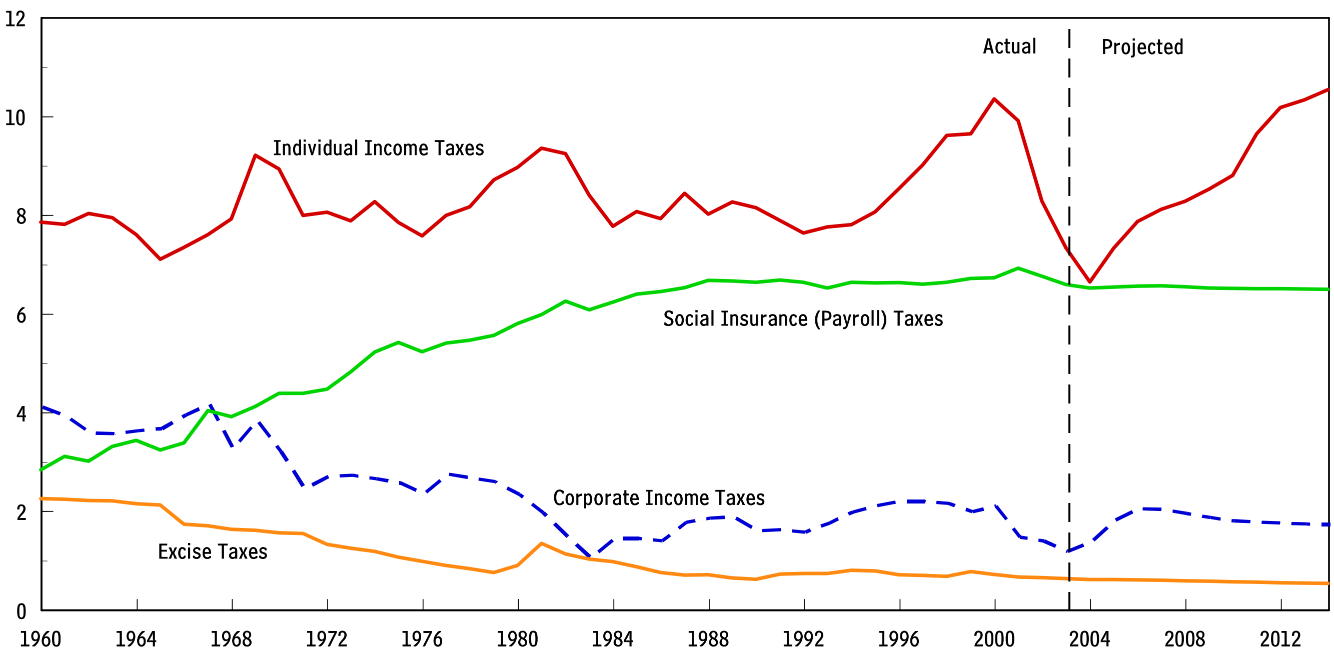
Historically, the post-World War II period has witnessed the declining importance of corporate income and excise taxes and the rising significance of payroll taxes. Since the early 1950s, the former two tax sources combined have declined from nearly half of receipts to less than 15 percent. Over the same period, payroll taxes have increased from slightly more than 10 percent of receipts to more than a third today.

The current composition of tax sources is somewhat unusual—but only temporary. In 2004, receipts from the individual income tax ($762 billion) and from payroll taxes ($747 billion) are expected to be roughly the same. That circumstance, which has not occurred since 1941, can be traced to the sharp decline in individual income tax receipts in the past few years due to both tax law changes and economic events.

Figure 4-3.

Revenues, by Source, as a Share of GDP, 1960 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

Over the coming decade, the relative contributions of the different revenue sources are expected to shift significantly, and the amount of revenue collected from the economy is projected to increase from its current, unusually low level. Over the next two years, economic recovery and the expiration of certain tax cuts are projected to boost the share of receipts from individual income taxes. After 2006 through the end of the decade, receipts will rise more gradually relative to GDP. And later in the projection period, with the expiration of the Economic Growth and Tax Relief Reconciliation Act at the end of 2010, individual income taxes will increase further relative to GDP and constitute more than half of all receipts. Corporate income taxes are also expected to grow in importance as profits recover from their recent recession lows. But after rising to more than 2 percent of GDP in 2006, they are expected to slip slightly over time as profits fall as a share of the total economy. (For more information on tax bases and tax liability and their relationship to GDP, *see Box 4-1*.) EGTRRA will have a profound effect on the importance of estate and gift taxes—which are expected to drop to historically low levels relative to GDP in 2010 and 2011 before regaining their previous importance after EGTRRA expires. Excise taxes will continue their slow decline in significance as a revenue source.

Those changes—especially the ones associated with the individual income tax—will markedly increase the total taxes collected by the federal government. From the lowest ratio of taxes to GDP in more than half a century—an estimated 15.8 percent of GDP in 2004—receipts in CBO's projection rise to more than 20 percent of GDP in 2014, a level surpassed only once in the same 50-year period.

Revisions to CBO's August Revenue Projections

Last August, CBO projected that receipts would total $27 trillion over the 2004-2013 period *(see Table 4-1 on page 76).* The current projection for that period is $26.2 trillion, a reduction of 3 percent ($790 billion). The reduction came in the form of lower individual income tax receipts (which have declined by $513 billion), social insurance taxes ($281 billion), and receipts from the Federal Reserve System ($26 billion). Modest increases in the

Box 4-1.

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

The first approximation of the individual income tax base includes dividends, interest, wages and salaries, rent, and proprietors' income. This measure, referred to here as **taxable personal income,** excludes depreciation, taxes on businesses (such as corporate income and excise taxes), retained corporate profits, and employee fringe benefits that are not received by individuals in taxable form.

This income measure must be narrowed further to obtain the tax base of the income tax. Some of this income 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 income earned in retirement accounts, on which tax is paid not when the income is accrued but when the person retires and begins to draw down the account. Also, personal interest and rental income contain 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.

Further adjustments, both additions and subtractions, must be made to derive taxpayers' **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 made to tax-deductible individual retirement accounts and 401(k) plans are subtracted, but distributions to retirees from those plans are added. A variety of other, smaller adjustments must be made to reflect the various adjustments that taxpayers make.

Exemptions and deductions are subtracted from AGI to yield **taxable income,** to which progressive tax rates—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 now six.) The tax that results from applying those rates to taxable income 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 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 regular tax. The ratio of tax liability to AGI is the **effective tax rate on AGI.**

other revenue sources offset those declines very slightly ($30 billion) over the 10-year period.

Less than $500 million of CBO's revisions was due to legislative changes since the last forecast. Two laws in particular affected receipts in CBO's projection: the Military Family Tax Relief Act of 2003 (Public Law 108-121), enacted in November; and the Medicare Prescription Drug, Improvement, and Modernization Act of 2003 (P.L. 108-173), enacted in December. The largest revenue effect from the Military Family Tax Relief Act resulted from providing reservists with a tax deduction for travel ex-

Box 4-1.

Continued

The Social Insurance Tax Base

Social insurance taxes, the second largest source of receipts, use payroll as their base. Those taxes largely fund Social Security and the 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. Hospital Insurance taxes are not subject to a taxable maximum.

The Corporate Income Tax Base

Corporate profits are the tax base of the corporate income tax. Profits are measured in different ways in the national income and product accounts. Several adjustments can be made to the reported profit measures to better approximate what is taxed by the corporate income tax.

First, different depreciation measures cause important differences in the measurement of corporate profits. **Economic profits** are measured 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 decline in value at a faster rate than the best estimates of how fast its value actually falls, allowing firms to report taxable profits that are smaller than economic profits.

Second, the profits of the Federal Reserve System are included in economic and book profits, but they are not taxed under the corporate income tax (they are instead remitted to the Treasury as miscellaneous receipts).

Third, economic and book profits both include certain foreign-source income of U.S. multinational corporations. Foreign-source income is taxed at very low effective rates in part because it is generally taxable only when it is "repatriated," or returned, to the U.S. parent company. In addition, it is taxed at low rates because corporations can offset their domestic tax by the amount of foreign taxes paid on that income, within limits.

Several other, smaller differences exist between book profits 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 the credit 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.**

Despite many adjustments that must be made to calculate the actual tax bases, a ready approximation is the sum of wages and salaries, nonwage personal income, and corporate book profits. Those items pick up most of the bases of the individual income, corporate income, and social insurance taxes and therefore constitute the bulk of taxed income.

penses without regard to whether they itemize their deductions. The revenue effects of the recently enacted Medicare law were largely offsetting. The legislation reduces revenues by providing qualifying taxpayers with health savings accounts to pay for certain expenses out of pretax income. At the same time, it increases revenues as businesses reduce expenditures on nontaxable health benefits and increase expenditures on taxable wages and pensions.

Most of the revision since August—approximately four-fifths of the change in projected receipts over the 2004-

Table 4-1.

Changes in CBO's Projections of Revenues Since August 2003

(Billions of dollars)

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	Total, 2004-2013
Revenues in CBO's August 2003 Baseline	1,825	2,064	2,276	2,421	2,564	2,723	2,880	3,165	3,430	3,634	26,982
Legislative Changes	*	-1	*	*	*	*	**	**	**	**	*
Other Changes											
Economic	7	1	-15	-36	-55	-72	-89	-109	-132	-158	-659
Technical	-15	-16	-4	1	-3	-7	-5	-20	-25	-35	-130
Subtotal	-8	-14	-20	-36	-59	-79	-94	-129	-158	-193	-789
Total Changes	**-8**	**-15**	**-20**	**-36**	**-59**	**-79**	**-94**	**-129**	**-158**	**-193**	**-790**
Revenues in CBO's January 2004 Baseline	1,817	2,049	2,256	2,385	2,506	2,644	2,786	3,036	3,272	3,441	26,192

Source: Congressional Budget Office.

Notes: * = loss of less than $500 million; ** = gain of less than $500 million.

2013 period—was the result of CBO's revised economic forecast. Changes in the economic forecast had a slightly positive effect on revenues in 2004 and 2005 but an increasingly negative impact on revenues during the remainder of the projection period. The revised economic forecast affected projected receipts in three important ways. First, it lowered inflation, which tended to reduce receipts from all sources. Second, it increased real growth, which tended to raise receipts. And third, it reduced the share of income realized as wages and salaries—the most highly taxed income source—which tended to lessen individual income and payroll taxes. The forecast's lower inflation is greater than its increased real growth, so that it projects lower nominal income, and the net effect of the three changes in the economic forecast was to reduce projected receipts. The effect of real growth is greatest in the earlier years of the projection period, so the downward revision from economic factors is greatest in the later years.

The downward revision of projected receipts attributable to CBO's updated economic forecast is primarily nominal, not real. Measured in constant dollars, there is little change in the 10-year total of receipts attributable to the new economic projection. This is because the negative revenue effect of the change in the wage and salary share was about the same size as the positive revenue effect of higher real growth. Hence, the net decline in receipts due to changes in the economic forecast is roughly that caused by lower inflation.

Nonetheless, the changed economic forecast explains most of the lower ratio of receipts to GDP relative to last August's projection, from 16.2 percent to 15.8 percent in 2004, and by varying amounts in later years. The effects of inflation and real growth on that ratio are relatively small, since they tend to affect both receipts and GDP proportionately. Because the share of income realized as wages and salaries is smaller than in the August projection, however, the ratio of receipts to GDP in CBO's outlook is now lower.

The remaining reduction in projected revenues since August is technical, that is, a result of changes in estimates of how much that income will generate in tax receipts. The downward revision is $15 billion or more in each of the first two years and in the last three years of the projection. The technical revisions in the 2006-2010 period are relatively small.

Most of the technical revisions occur within CBO's projections of the individual income tax. These revisions are primarily due to information from 2001 individual income tax returns that became available recently and has

Table 4-2.

CBO's Projections of Revenues

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
							In Billions of Dollars							
Individual Income Taxes	794	762	885	997	1,074	1,146	1,237	1,335	1,528	1,684	1,786	1,903	5,339	13,576
Corporate Income Taxes	132	161	224	264	273	275	276	278	287	297	307	320	1,312	2,801
Social Insurance Taxes	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732
Excise Taxes	68	70	73	76	78	81	83	85	88	90	93	95	391	842
Estate and Gift Taxes	22	24	23	26	24	25	26	19	20	40	43	47	125	293
Customs Duties	20	21	21	23	24	25	27	28	29	30	30	31	121	269
Miscellaneous Receipts	35	32	34	38	43	47	49	52	54	56	58	60	211	490
Total	**1,782**	**1,817**	**2,049**	**2,256**	**2,385**	**2,506**	**2,644**	**2,786**	**3,036**	**3,272**	**3,441**	**3,629**	**11,840**	**28,004**
On-Budget	1,259	1,273	1,477	1,655	1,756	1,847	1,954	2,065	2,283	2,486	2,620	2,771	8,688	20,913
Off-Budget[a]	524	545	572	601	629	659	690	721	753	786	821	858	3,152	7,091
							As a Percentage of GDP							
Individual Income Taxes	7.3	6.6	7.3	7.9	8.1	8.3	8.5	8.8	9.6	10.2	10.3	10.5	8.0	9.1
Corporate Income Taxes	1.2	1.4	1.8	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	2.0	1.9
Social Insurance Taxes	6.6	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5	6.5
Excise Taxes	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.6	0.5	0.5	0.5	0.6	0.6
Estate and Gift Taxes	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.1	0.1	0.2	0.2	0.3	0.2	0.2
Customs Duties	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2	0.2
Miscellaneous Receipts	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	0.3
Total	**16.5**	**15.8**	**16.9**	**17.8**	**18.0**	**18.1**	**18.2**	**18.3**	**19.1**	**19.8**	**19.9**	**20.1**	**17.8**	**18.7**
On-Budget	11.6	11.1	12.2	13.0	13.3	13.3	13.5	13.6	14.4	15.0	15.1	15.3	13.1	14.0
Off-Budget[a]	4.8	4.7	4.7	4.7	4.8	4.8	4.8	4.7	4.7	4.7	4.7	4.7	4.7	4.7

Source: Congressional Budget Office.

a. Social Security.

been incorporated into CBO's current projection models. In preparing its projections last August, CBO had only preliminary summary data tabulated from 2001 individual income tax returns to explain why individual income tax liability in 2001 fell short of projections. Since then, CBO has conducted a detailed analysis of a sample of tax returns, which suggests that some of the decline in receipts—believed to be temporary in August—is likely to be permanent.

Also accounting for some technical revisions, corporate receipts in recent months have been weaker than expected given the strong surge in profits as reported in the national income and product accounts (NIPAs). And CBO has reestimated the timing and amount of revenue losses that result from certain provisions enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 (P.L. 108-27).

Revenue Projection in Detail

Individual Income Taxes

Individual income taxes account for most of the projected change in revenues as a share of GDP over the next 10 years *(see Table 4-2)*. That is not surprising: they were also responsible for most of the rise in that share during the late 1990s and most of the decline since 2000. Individual income tax receipts grew at an average rate of more than 10 percent a year from 1993 to 2000 (except for 1999,

Table 4-3.

CBO's Projections of Individual Income Tax Receipts and the NIPA Tax Base

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Individual Income Tax Receipts														
In billions of dollars	794	762	885	997	1,074	1,146	1,237	1,335	1,528	1,684	1,786	1,903	5,339	13,576
As a percentage of GDP	7.3	6.6	7.3	7.9	8.1	8.3	8.5	8.8	9.6	10.2	10.3	10.5	n.a.	n.a.
Annual growth rate	-7.5	-4.0	16.2	12.7	7.6	6.8	7.9	7.9	14.4	10.2	6.1	6.5	n.a.	n.a.
Taxable Personal Income														
In billions of dollars	7,436	7,792	8,226	8,647	9,045	9,481	9,942	10,392	10,843	11,315	11,821	12,346	45,342	102,059
As a percentage of GDP	68.7	67.9	68.0	68.2	68.3	68.4	68.5	68.4	68.4	68.3	68.3	68.3	n.a.	n.a.
Annual growth rate	1.9	4.8	5.6	5.1	4.6	4.8	4.9	4.5	4.3	4.4	4.5	4.4	n.a.	n.a.
Individual Receipts as a Percentage of Taxable Personal Income	10.7	9.8	10.8	11.5	11.9	12.1	12.4	12.8	14.1	14.9	15.1	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 (NIPAs) rather than as reported on tax returns. An important difference, therefore, is that it excludes capital gains realizations.

n.a. = not applicable.

when they were reduced by the cuts enacted in the Taxpayer Relief Act of 1997). Their share of GDP reached a historical peak of 10.3 percent in 2000. That trend was halted by the recession that began in March 2001 and, to a lesser extent, by the tax cuts enacted in EGTRRA. Individual income tax receipts fell to 9.9 percent of GDP in 2001, to 8.3 percent in 2002, and—with the help of additional tax cuts enacted in JGTRRA—to 7.3 percent in 2003.

Because some of the factors causing the low level of receipts of the past few years are temporary, and because the design of the income tax system causes revenues to grow faster than output, CBO projects that individual income tax receipts will increase relative to GDP starting in 2005 and lasting throughout the coming decade. They are projected to rise above their post-World War II average of 8.1 percent of GDP by 2008. The rise will continue and become especially pronounced after 2010, when EGTRRA tax cuts expire. Individual income tax receipts are projected to reach a new historical peak of 10.5 percent of GDP in 2014 *(see Table 4-3).*

Taxes in 2004. CBO projects that in both dollar terms and as a percentage of GDP, individual income tax receipts will decline in 2004. The drop will result primarily from the effects of recent legislation. The projected decline in revenues would have been greater if not for expected economic growth in 2004, which should raise revenues.

Recent tax legislation should significantly affect both the growth of tax receipts in 2004 and the distribution of those receipts over the course of the year. CBO expects that the tax legislation enacted in the past three years, especially the legislation enacted in 2003, will reduce receipts of individual income taxes by over $90 billion more in 2004 than it did in 2003, or about 5 percent of total revenue. A substantial portion of the reduced revenues will result from the filing of 2003 income tax returns. The lower final payments and increased refunds will occur primarily during the period from February to May of 2004.

CBO estimates that net final payments with income tax returns will fall by roughly $45 billion in 2004 as a result of the timing of the tax cuts enacted in JGTRRA. The legislation, which was enacted in May 2003, made reductions in tax rates and changes to certain tax brackets effective for the entire calendar year. Although reduced withholding rates incorporating those changes went into effect quickly, they generally applied to income earned only during the second half of the calendar year. As a result, taxpayers who were employed during the first half of 2003 had taxes withheld from their paychecks at higher tax rates than would now apply. Therefore, when those taxpayers file their returns for tax year 2003, they should either receive larger refunds or pay less in final payments than they would have without the law change. Taxpayers could have had their employers further reduce their withholding during the second half of 2003, but evidence suggests that most taxpayers do not do so in response to tax law changes. A similar effect occurs with estimated payments of taxes for nonwage income; taxpayers probably were slow to adjust their quarterly payments in response to the new tax rates on dividends and other law changes.

Whether the reduced net final payments will occur more in the form of increased refunds or decreased final payments is difficult to predict. That split depends on how closely taxpayers otherwise aligned their withholding and quarterly estimated payments to total liabilities for the year, a relationship that varies from year to year. CBO expects more than half of the reduction in receipts to occur as increased refunds. Because taxpayers with refunds tend to file their tax returns earlier than those with tax due (who generally file near the April 15 deadline), much of the revenue reduction will occur in February and March.

The 2004 revenue reductions from recent tax cuts that are not reflected in net final payments with tax returns occur either as withholding or estimated payments. Those reductions, which subtract about $60 billion from growth in receipts, should occur fairly evenly over the course of the fiscal year. Since withholding and estimated payments together typically account for between 95 percent and 110 percent of total individual income tax liabilities, the effects of recent tax cuts on withholding and estimated payments are disproportionately small. The combination of the $45 billion revenue reduction from net final payments with tax returns and $60 billion from withholding and estimated payments does not represent the full effects of the law change on revenue growth. About $14 billion of that decrease is offset because JGTRRA established one-time advance refunds of child tax credits in July and August of 2003, a provision that will not be in effect this year.

The projected reduction in individual income tax revenues in 2004 will be mitigated by the effects of economic growth. CBO projects that taxable personal income as measured in the national income accounts will grow by 4.8 percent on average in 2004, after a lackluster 1.9 percent growth in 2003. In the second half of calendar year 2003, withholding of individual income and payroll taxes, adjusted to remove the effects of the recent tax cuts, grew in the range of 3 percent to 4 percent from amounts withheld during the comparable period in 2002. That growth is expected to pick up in 2004 consistent with growth in incomes, especially wages and salaries.

The Future Pattern of Individual Income Tax Receipts. In 2005 and 2006, CBO's projected pattern of revenue growth reflects in part the nation's continued recovery from recession. Over that period, individual income tax receipts are expected to increase as economic growth picks up again. Despite the near-term effects of the economic recovery, individual income tax receipts over the 2005-2014 period are influenced primarily by four other factors that cause those receipts to rise faster than either GDP or taxable personal income in every year.

First, changes in tax law—principally those enacted in EGTRRA and JGTRRA—will profoundly alter the pattern of receipts growth. Four major tax provisions—the child tax credit, the expanded 15 percent bracket and standard deduction ("marriage penalty relief"), the expanded 10 percent bracket, and the alternative minimum tax exemption—are reduced in tax year 2005 from the full value they have in tax years 2003 and 2004. This causes a significant jump in projected taxes in fiscal years 2005 and 2006. The first three of these tax provisions are phased back in by tax year 2010; and along with a phaseout of restrictions on itemized deductions and personal exemptions for high-income taxpayers during tax years 2006-2010, they tend to reduce the growth of individual income tax receipts. The lower rates for dividends and capital gains expire after tax year 2008, tending to increase receipts. And all provisions of EGTRRA that are still in effect in 2010 are scheduled to expire at the end of that calendar year, which will cause revenues to climb sharply.

Second, over the 10-year period, several inherent characteristics of the tax system will boost effective tax rates, thereby increasing the receipts generated by the economy. The rise in the effective rate is fueled in part by the phenomenon known as real bracket creep, in which the overall growth of real income pushes more income into higher tax brackets. In addition, the AMT—which is not indexed for inflation—will affect an increasing number of

Box 4-2.

The Growing Significance of the Alternative Minimum Tax in CBO's Projections

The alternative minimum tax (AMT) is becoming an important presence in discussions of tax policy and in the Congressional Budget Office's (CBO's) revenue projections. It is one of the reasons that receipts are projected to grow relative to gross domestic product (GDP) over the next 10 years. With each passing year, the AMT plays a bigger role in revenue projections.

Characteristics of the AMT

The AMT is a parallel income tax system with fewer exemptions, deductions, and rates than the regular income tax. It was enacted to prevent high-income taxpayers from excessively reducing the amount of tax they owe by using the regular code's various preferences—features of the tax code that favor certain activities by taxing the income associated with them at a lower rate. Taxpayers with potential AMT liability must calculate their taxes under both the AMT and the regular income tax and pay whichever figure is higher. (The amount by which a taxpayer's AMT calculation exceeds his or her regular tax calculation is considered the taxpayer's AMT liability.)

Like the rate structure of the regular income tax, the AMT extracts a greater proportion of overall income as real income rises. But unlike the regular income tax, the AMT is not indexed to inflation. Consequently, inflation increases the amount of income to which the AMT applies and the number of taxpayers subject to it each year. Those effects are compounded by reductions in marginal tax rates still scheduled to phase in before 2010. Because those cuts reduce regular tax liability relative to AMT liability, they further increase the AMT's contribution to total revenues.

The preferences not allowed under the AMT include personal exemptions and the standard deduction, so the AMT reaches some taxpayers not ordinarily thought to be exploiting "loopholes" to avoid taxation of high incomes. That situation increases over time as nominal income grows. For example, in tax year 2005, a married taxpayer earning $90,000 who has three children and reports a typical set of deductions would be subject to the AMT.

The AMT's Impact Over the Next 10 Years

Comparing the number of taxpayers subject to the AMT and the amount of revenue it raises in 2003 with the same measures in 2014 (four years after the remaining provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 [EGTRRA] expire) demonstrates how the impact of the AMT increases in part as a result of nominal income growth. CBO estimates that in 2003, 2 million tax returns had AMT liability, and receipts from the tax totaled $11 billion *(see figure at right).* In 2014, about 23 million returns are projected to have AMT liability, and the tax will add an estimated $55 billion in revenues. Over that 12-year span, the AMT's contribution to individual income tax receipts more than doubles, rising from 1.4 percent of those receipts to 2.9 percent.

In the years in between, the rise and fall of the AMT's projected effects also reflect the phasing in

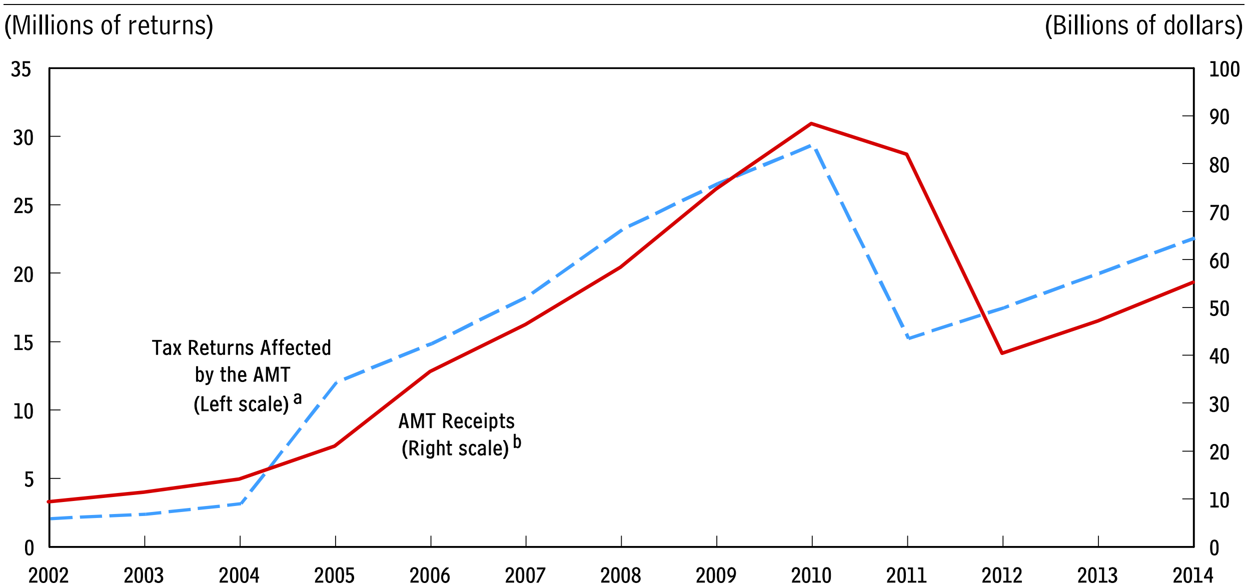
taxpayers and growing amounts of income in future years. (For a more detailed description of the increasing significance of the AMT in CBO's revenue projections, *see Box 4-2.*) Also pushing up the effective rate are taxable distributions from tax-deferred retirement accounts, such as individual retirement accounts and 401(k) plans, which are expected to increase as the population ages. Contributions to those accounts were exempt from taxation when they were made, which reduced taxable income in earlier years. Now, as more retirees take distribu-

Box 4-2.

Continued

and expiration of provisions of EGTRRA and JGTRRA. When a provision in JGTRRA that increased the amount of income exempt from the AMT expires in 2005, the number of returns subject to the AMT is expected to rise, climbing from 3 million in 2004 to 12 million the following year; as a result, AMT revenues are projected to increase from $14 billion in 2004 to $21 billion in 2005. In addition to the effects of nominal income growth, the phasing in of tax cuts in the following years helps drive the number of AMT returns to about 29 million in 2010 (just before EGTRRA's provisions expire), and AMT revenues to nearly $90 billion, or about 7 percent of total individual income tax receipts. The subsequent decline in AMT receipts ($90 billion in fiscal year 2010 versus $40 billion in 2012) and in returns affected (29 million in tax year 2010 versus 15 million in 2011) indicates the degree to which the cuts in marginal tax rates under EGTRRA will have been muted by the AMT.

CBO's Projected 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. Some taxpayers are affected by the AMT but do not have AMT liability because the AMT limits their credits taken under the regular tax.

a. Calendar year basis.

b. Fiscal year basis.

tions from those accounts, the money becomes taxable, thereby increasing tax receipts relative to GDP.

Third, capital gains realizations—a significant contributor to past movements of receipts—play a much smaller but nonetheless positive role in CBO's projections. Although it estimates that capital gains realizations rose slightly in tax year 2003, CBO expects receipts from capital gains taxes to be lower in fiscal year 2004 because capital gains tax rates have been reduced *(see Table 4-4)*. But the declines in realizations of 2001 and 2002 left them well below the level consistent with their historical relationship to GDP *(see Figure 4-4)*. Consequently, they

Table 4-4.

Actual and Projected Capital Gains Realizations and Taxes

	Capital Gains Realizations[a]		Capital Gains Tax Liabilities[a]		Capital Gains Tax Receipts[b]		
	In Billions of Dollars	Percentage Change from Previous Year	In Billions of Dollars	Percentage Change from Previous Year	In Billions of Dollars	Percentage Change from Previous Year	Capital Gains Tax Receipts as a Percentage of Total Individual Tax Receipts
1990	124	-20	28	-21	32	-14	6.8
1991	112	-10	25	-11	27	-17	5.7
1992	127	14	29	16	27	1	5.6
1993	152	20	36	25	32	20	6.3
1994	153	0	36	0	36	12	6.7
1995	180	18	44	22	40	10	6.8
1996	261	45	66	50	54	36	8.3
1997	365	40	79	19	72	33	9.8
1998	455	25	89	12	84	16	10.1
1999	553	22	112	26	99	19	11.3
2000	644	16	127	14	119	20	11.8
2001	349	-46	66	-48	100	-16	10.0
2002	256	-27	47	-29	57	-42	6.7
2003	274	7	42	-11	45	-22	5.6
2004	328	20	46	11	44	-2	5.7
2005	363	11	52	13	49	12	5.5
2006	397	9	57	10	54	11	5.5
2007	429	8	62	9	59	9	5.5
2008	531	24	76	22	64	8	5.6
2009	378	-29	68	-10	76	19	6.2
2010	475	26	86	27	76	0	5.7
2011	501	6	93	8	90	17	5.9
2012	528	5	98	5	96	7	5.7
2013	555	5	103	5	100	5	5.6
2014	583	5	108	5	105	5	5.5

Source: Congressional Budget Office.

Note: Capital gains realizations represent net positive long-term gains. Data for realizations and liabilities after 2000 and data for tax receipts in all years are estimated or projected by CBO. Data for realizations and liabilities before 2001 are estimated by the Treasury Department.

a. Calendar year basis.

b. Fiscal year basis. This measure is CBO's estimate of when tax liabilities are paid to the Treasury.

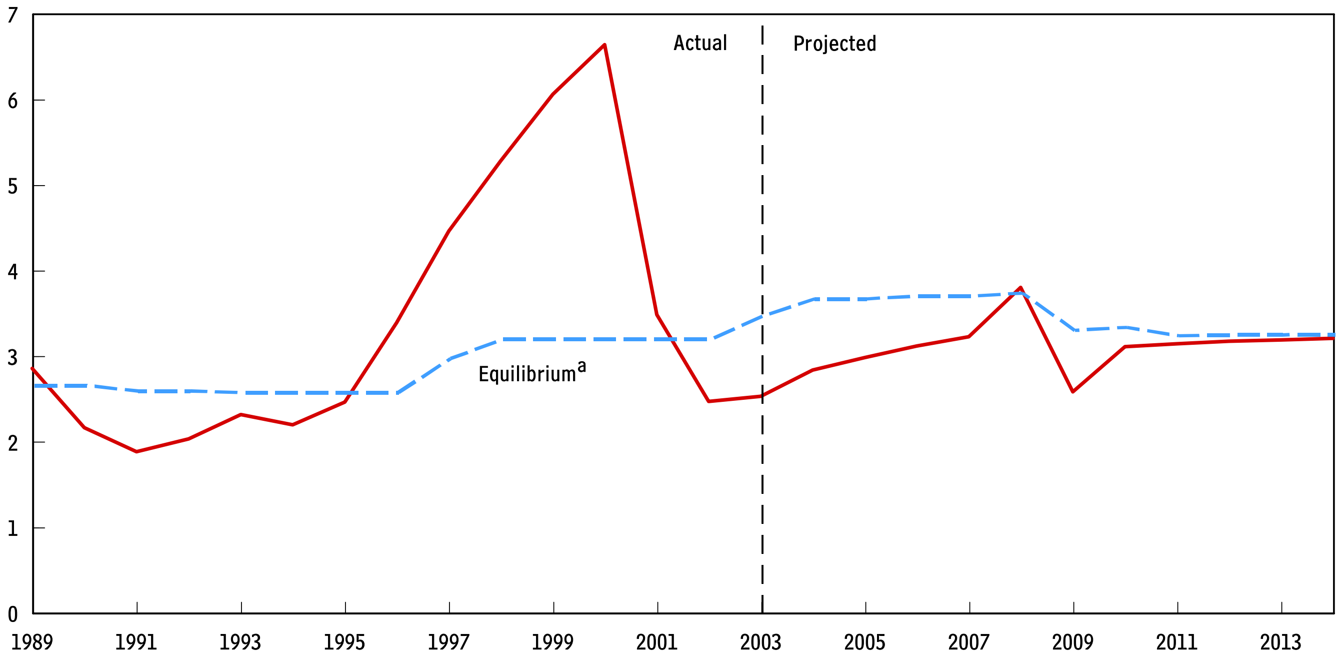
are projected to rise gradually to that level, moderately boosting receipts as a percentage of GDP over the 10-year projection period. That rise is punctuated by a sharp increase in 2008 and a decrease the following year as taxpayers accelerate gains into tax year 2008 before the rate cut expires.

Finally, current collections of individual income taxes are still running below the amounts that would be expected given the level of economic activity, estimated capital gains realizations, retirement distributions, and other factors known to influence the average tax rate. That shortfall is likely to continue for a few years. However, CBO

Figure 4-4.

Capital Gains Realizations as a Share of GDP, Calendar Years 1989 to 2014

(Percentage of GDP)



Source: Congressional Budget Office.

a. The equilibrium relationship of capital gains realizations to GDP is measured as the average ratio of gains to GDP from 1954 to 2002, adjusted for differences between each year's tax rate on capital gains and the average rate over the period. A lower tax rate on capital gains corresponds to a higher equilibrium relationship of gains to GDP, such as between 2003 and 2008. Although the tax rate reductions in those years are scheduled to expire, CBO assumes that realizations approach those rates while the tax rate reductions are in effect.

assumes that it will diminish in later years. Its gradual contraction also tends to increase individual tax receipts relative to GDP over the projection period.

Changes Since August 2003. Compared with the projections it made last August, CBO has reduced its projection of individual income tax receipts by $513 billion. A tiny part of that, about $2.5 billion, was due to legislation. Three-quarters, or $390 billion, was the result of changes in CBO's economic forecast, principally the reduction in inflation and in the share of income received in the form of wages and salaries. The remaining $121 billion of the reduction reflects technical factors.

The technical revision came largely from a combination of reestimates of the effects of the recent tax cut and from information derived from 2001 individual income tax returns that recently became available and has been incorporated into CBO's projection models. Reestimates of the timing and amount of revenue losses from JGTRRA lowered receipts in the shorter term. Information from 2001 returns caused CBO to reduce receipts in the longer term. In August, the shortfall in current receipts that could not be explained by CBO's projection models was assumed to be temporary, and it was not projected to continue beyond the first several years of the forecast period. Information from 2001 tax returns indicates that some of that shortfall is likely to be permanent. Hence, the projection is reduced in the later years of the forecast period.

Social Insurance Taxes

In CBO's projections, revenues from social insurance taxes claim a roughly constant share of GDP, remaining at about 6.5 percent of GDP from 2004 through 2014 *(see Table 4-5).* In relation to wages and salaries—the approximate base of those payroll taxes—revenues decline somewhat, from 14.2 percent in 2004 to 14.0 percent by 2014.

Table 4-5.

CBO's Projections of Social Insurance Tax Receipts and the Social Insurance Tax Base

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Social Insurance Tax Receipts														
In billions of dollars	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732
As a percentage of GDP	6.6	6.5	6.5	6.5	6.6	6.5	6.5	6.5	6.5	6.5	6.5	6.5	n.a.	n.a.
Annual growth rate	1.7	4.7	5.7	5.2	4.6	4.3	4.4	4.5	4.4	4.4	4.4	4.4	n.a.	n.a.
Wages and Salaries														
In billions of dollars	5,051	5,257	5,563	5,859	6,134	6,435	6,744	7,057	7,370	7,693	8,033	8,386	30,735	69,274
As a percentage of GDP	46.6	45.8	46.0	46.2	46.3	46.4	46.5	46.5	46.5	46.5	46.4	46.4	n.a.	n.a.
Annual growth rate	1.9	4.1	5.8	5.3	4.7	4.9	4.8	4.6	4.4	4.4	4.4	4.4	n.a.	n.a.
Social Insurance Tax Receipts as a Percentage of Wages and Salaries	14.1	14.2	14.2	14.2	14.2	14.1	14.0	14.0	14.0	14.0	14.0	14.0	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.

The largest generators of payroll tax receipts are taxes for Social Security (officially called Old-Age, Survivors, and Disability Insurance, or OASDI) and Medicare's Hospital Insurance (HI). A small share of social insurance tax revenues comes from unemployment insurance taxes and contributions to other federal retirement programs *(see Table 4-6)*.

Social Security and Medicare taxes are calculated as a percentage of covered wages. Unlike the HI tax, which applies to all covered wages, the Social Security tax applies only up to a taxable maximum, which is indexed to the growth of wages over time. Consequently, receipts from OASDI and HI taxes tend to remain fairly stable as a proportion of income as long as covered wages are a stable share of GDP and the distribution of income from wages remains relatively unchanged.

CBO projects that social insurance tax receipts will decrease slightly this year relative to GDP. That decline occurs because the share of total income claimed by wages is expected to fall. As the economy continues to recover, corporate profits are projected to grow rapidly, decreasing the ratio of wages to GDP. That decline is mitigated by factors that are raising social insurance receipts relative to wages, notably a large anticipated increase in state unemployment taxes as states replenish their trust funds following the outflow of funds for unemployment benefits during the recession.

From 2005 onward, payroll tax receipts are expected to increase slightly and then decline very gradually as a share of GDP. CBO projects that as the economy swings back to full employment, the ratio of wage and salary income to total income will increase, boosting social insurance receipts relative to GDP. After that, social insurance receipts will slowly decline as a fraction of both wages and GDP for three reasons: states will have finished replenishing their unemployment trust funds, revenues associated with other federal retirement programs will be lower as the number of workers covered by Railroad Retirement and the old Civil Service Retirement System declines, and a slightly larger fraction of total wage and salary income will be above the maximum level of earnings subject to Social Security taxes.

Table 4-6.

CBO's Projections of Social Insurance Tax Receipts, by Source

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Social Security	524	545	572	601	629	659	690	721	753	786	821	858	3,152	7,091
Medicare	147	155	164	173	181	190	199	208	218	227	238	248	906	2,045
Unemployment Insurance	33	39	45	49	50	50	50	51	53	55	58	60	244	521
Railroad Retirement	4	4	4	4	4	4	4	4	4	4	4	4	19	40
Other Retirement	5	4	4	4	4	4	4	3	3	3	3	3	19	34
Total	713	747	789	830	868	906	946	988	1,031	1,076	1,123	1,173	4,340	9,732

Source: Congressional Budget Office.

Compared with its projections last August, CBO is now estimating about $281 billion less in social insurance tax receipts during the 2004-2013 period. Changes in CBO's economic forecast, mainly lower projections of nominal wages and salaries because of the expected slowdown in long-term inflation, account for $266 billion of that change. Nearly all of the rest is due to technical changes resulting primarily from the availability of recent data on wages subject to the payroll tax, which show that corrected receipts for 2002 were lower than the figure used in CBO's August projections. Legislation had little impact.

Corporate Income Taxes

Corporate income taxes contributed to some of the increase in federal revenues in the 1990s as corporate profits surpassed their performance of the previous two decades. But the recent recession has reduced profits—and therefore corporate income tax receipts—substantially. Revenues have been further reduced by the countercyclical tax incentives enacted as part of the Job Creation and Worker Assistance Act of 2002 (JCWAA) and JGTRRA. Those receipts (adjusted to take into account legislated shifts in the timing of collections) fell from 2.1 percent of GDP in 2000 to 1.7 percent in 2001 and 1.2 percent in 2002. They were roughly stable as a share of GDP in 2003, and CBO expects them to increase strongly relative to GDP over the next three years, reaching 2.1 percent in 2006. They will then slip slightly relative to GDP in the remaining years of the projection period.

Corporate income tax revenues have followed much the same pattern as individual income tax receipts, rising markedly in the late 1990s and then falling in recent years. In the case of corporate taxes, however, the peak and decline occurred earlier, and the drop was even more significant. From 1994 through 1998, corporate tax receipts grew more rapidly than the overall economy. That performance was driven largely by very strong corporate profits. But as a percentage of GDP, corporate receipts peaked in 1998 (although they remained relatively strong in 1999 and 2000). After that, corporate receipts dropped even more significantly than individual receipts did. In 2002 and 2003, corporate tax receipts were lower as a percentage of GDP than they had been since the mid-1980s.

That drop was caused almost entirely by the slowing of the economy and the effects of tax legislation enacted in 2002 and 2003. JCWAA and JGTRRA allowed more-rapid write-offs ("partial expensing") of investment undertaken from 2001 through 2004. In addition, JCWAA's expanded "carryback" provision increased firms' ability to use losses from 2001 and 2002 to obtain refunds of taxes paid in previous years. The results of those changes in tax law were a substantial decrease in corporate tax payments, an increase in corporate tax refunds, and a significant fall in net corporate tax receipts. Adjusted for legislated shifts in payment dates, corporate receipts rose in 2003 but remained well below 2001 levels.

Table 4-7.

CBO's Projections of Corporate Income Tax Receipts and Tax Bases

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Corporate Income Tax Receipts														
In billions of dollars	132	161	224	264	273	275	276	278	287	297	307	320	1,312	2,801
As a percentage of GDP	1.2	1.4	1.8	2.1	2.1	2.0	1.9	1.8	1.8	1.8	1.8	1.8	n.a.	n.a.
Annual growth rate	-11.0	22.5	38.5	18.2	3.5	0.7	0.1	1.0	3.0	3.5	3.6	4.0	n.a.	n.a.
Corporate Book Profits														
In billions of dollars	819	938	1,215	1,353	1,354	1,358	1,357	1,382	1,435	1,500	1,569	1,645	6,636	14,168
As a percentage of GDP	7.6	8.2	10.0	10.7	10.2	9.8	9.3	9.1	9.0	9.1	9.1	9.1	n.a.	n.a.
Annual growth rate	15.7	14.5	29.5	11.4	0	0.3	-0.1	1.9	3.8	4.5	4.6	4.9	n.a.	n.a.
Taxable Corporate Profits[a]														
In billions of dollars	565	666	926	1,044	1,029	1,015	996	1,000	1,030	1,070	1,113	1,161	5,010	10,385
As a percentage of GDP	5.2	5.8	7.7	8.2	7.8	7.3	6.9	6.6	6.5	6.5	6.4	6.4	n.a.	n.a.
Annual growth rate	21.9	17.9	39.1	12.8	-1.5	-1.3	-1.9	0.5	3.0	3.9	4.0	4.4	n.a.	n.a.
Corporate Receipts as a Percentage of Taxable Profits	23.3	24.3	24.2	25.3	26.6	27.1	27.7	27.8	27.8	27.7	27.6	27.5	n.a.	n.a.
Adjusted Corporate Receipts as a Percentage of Taxable Profits[b]	24.5	24.3	23.5	25.3	26.6	27.1	27.7	27.8	27.8	27.7	27.6	27.5	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 in the national income and product accounts rather than as reported on tax returns.

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 shifts in corporate receipts from 2003 to 2004 enacted in the Jobs and Growth Tax Relief Reconciliation Act of 2003 and from 2004 to 2005 enacted in the Economic Growth and Tax Relief Reconciliation Act of 2001.

CBO's projection of corporate receipts for the next 10 years reflects a combination of continued recovery from the recession, the effects of the depreciation incentives and their expiration under current law, and longer-term changes in profits as a share of GDP. CBO expects corporate tax receipts in 2004 to rise by two-tenths of a percentage point of GDP and then grow more strongly, so that by 2006, they reach 2.1 percent of GDP. Those receipts will slowly slip from that level to 1.8 percent of GDP by the end of the projection period *(see Table 4-7).*

In CBO's economic forecast, corporate book profits—the underlying base of the corporate income tax—grow very rapidly from 2004 through 2006. (For more details of CBO's outlook for the economy, see Chapter 2.) Profits grew rapidly in 2003 and they are expected to continue to grow faster than GDP through 2006. That growth, particularly in 2004, is caused largely by recovery from the 2001 recession, during which profits were especially depressed. In addition, corporate profits and receipts are affected by provisions of JCWAA and JGTRRA. The partial-expensing provisions are scheduled to expire at the end of 2004. That expiration will raise book and taxable profits sharply in 2005, boosting receipts strongly in 2005 and 2006. Accelerated depreciation has the effect of

Table 4-8.

CBO's Projections of Excise Tax Receipts, by Category

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Highway Taxes	34	35	37	39	40	41	42	43	44	46	47	48	199	427
Airport Taxes	9	10	11	11	12	13	13	14	15	15	16	17	60	137
Telephone Taxes	6	6	7	7	8	8	8	9	9	10	10	11	38	86
Alcohol Taxes	8	8	8	9	9	9	9	9	9	9	10	10	44	91
Tobacco Taxes	8	8	8	8	8	8	8	8	8	8	8	8	41	81
Other Excise Taxes	2	2	2	2	2	2	2	2	2	2	2	2	10	21
Total	68	70	73	76	78	81	83	85	88	90	93	95	391	842

Source: Congressional Budget Office.

reducing tax liability immediately at the cost of higher liability later. Hence, beginning in 2005, the corporate income tax will begin to recoup some of its earlier loss of receipts.

After 2006, corporate book profits will decline gradually relative to GDP, CBO expects, thereby decreasing corporate tax receipts relative to GDP as well. That effect is somewhat muted by a small rise in receipts as a percentage of taxable profits. As profits decline relative to GDP, losses as a proportion of net profits are higher. Firms pay taxes to the government on the profits they earn, but they do not receive payments from the government if they lose money (except to the extent that they can carry their losses forward or backward to offset profits in other years). Consequently, the overall effective corporate tax rate—receipts divided by net profits—tends to be higher when net corporate profits are lower.

CBO's projection of corporate receipts over the 2004-2013 period is little changed—just $2 billion more—from that of last August. Changes in CBO's economic forecast caused the projection to rise by $14 billion, with the revenue-reducing effects of a lower inflation forecast (reducing nominal GDP and profits) more than offset by the revenue-increasing effects of higher profits as a share of GDP. Technical changes, which mostly reflect weak recent tax collections, reduced the projection by $11 billion.

Excise Taxes

Receipts from excise taxes are expected to continue their long-term decline as a share of GDP, falling from 0.6 percent in 2003 to 0.5 percent toward the end of the 10-year projection period. Most excise taxes—those generating about 80 percent of total excise revenues—are levied per unit of good or per transaction rather than as a percentage of value. Thus, excise receipts grow with real GDP, but they do not rise with inflation and therefore do not grow as fast as nominal GDP does.

Nearly all excise taxes fall into five major categories: highway, airport, telephone, alcohol, and tobacco taxes *(see Table 4-8).* Almost half of all excise receipts are earmarked by law to the Highway Trust Fund; they come primarily from taxes on gasoline and diesel fuel. Most airport and telephone excise taxes are levied on a percentage basis, so they grow at a faster rate than the other categories do. Tobacco and alcohol taxes are expected to remain roughly stable in nominal terms through 2014.

CBO's current projection of total excise tax receipts for the next 10 years is about $15 billion higher than the projection it published in August. Changes in CBO's economic forecast increase last August's projection by $5 billion, and technical adjustments raise projected excise receipts by another $10 billion over the 2004-2013 period. The technical changes reflect higher recent receipts from gasoline taxes, offset partially by a larger share of motor fuel consumption consisting of lower-taxed ethanol blends.

Estate and Gift Taxes

Under current law, estate and gift tax receipts change in importance over CBO's 10-year projection period: their share of GDP is forecast to decline from 0.2 percent in

Table 4-9.

CBO's Projections of Other Sources of Revenue

(Billions of dollars)

	Actual 2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Estate and Gift Taxes	22	24	23	26	24	25	26	19	20	40	43	47	125	293
Customs Duties	20	21	21	23	24	25	27	28	29	30	30	31	121	269
Miscellaneous Receipts														
Federal Reserve System earnings	22	21	23	27	32	35	38	40	42	43	45	47	154	372
Universal Service Fund	6	6	6	7	7	7	7	7	7	8	8	8	34	71
Other	7	5	5	5	5	5	5	5	5	5	5	5	23	47
Subtotal	35	32	34	38	43	47	49	52	54	56	58	60	211	490
Total	**76**	**77**	**78**	**88**	**92**	**97**	**102**	**99**	**102**	**125**	**131**	**139**	**457**	**1,052**

Source: Congressional Budget Office.

2003 to 0.1 percent in 2010 and 2011 before jumping back to 0.2 percent of GDP in 2012. That pattern results from the phaseout of the estate tax under EGTRRA and the subsequent reinstatement of the tax when the law expires at the end of 2010.

In the past, revenues from estate and gift taxes tended to grow more rapidly than income because the unified credit for the two taxes, which effectively exempts some assets from taxation, is not indexed for inflation. Under EGTRRA, however, the pattern of receipts over time is quite different. The estate tax is gradually being eliminated; the gift tax remains in the tax code but in a modified form. Today, tax law effectively exempts $1.5 million of an estate from taxation. EGTRRA will raise that amount in steps to $2.0 million in 2006 and $3.5 million in 2009. EGTRRA will also reduce the highest tax rate on estates in steps from 50 percent in 2002 to 45 percent by 2007 and then eliminate the tax in 2010. The law's provisions are scheduled to expire at the end of 2010, however, which means that the estate tax is set to return the following year. Because estate tax liabilities are paid after a lag, and because the gift tax remains in the tax code, receipts from estate and gift taxes do not disappear completely in CBO's projection period but instead reach a trough in 2010 and 2011 *(see Table 4-9)*. CBO estimates that after 2011 they will return to roughly their 2002 share of GDP.

The pattern of the phase-in of new provisions and the expiration of the cuts at the end of 2010 produces discrete increases and decreases in revenue from the tax over the 10-year forecast period *(see Figure 4-5)*. Not only does the effective exemption rise in steps, reducing revenues, but during the 2002-2005 period, the credit for state death taxes is converted to a less valuable deduction, which tends to raise receipts slightly. Because of the lag in payment, those provisions each have their effects on estate tax revenue in the following years. The changes in law inject greater uncertainty than usual into the projections.

CBO's current projections of estate and gift tax receipts are similar to those it produced last August. Changes in CBO's economic forecast have reduced the projection by $4 billion from 2004 to 2013. Small technical changes—including the impact of the stock market on projected wealth and reestimates of gift tax receipts around the time EGTRRA expires—net to an increase of $8 billion in receipts over 10 years compared with the August projection.

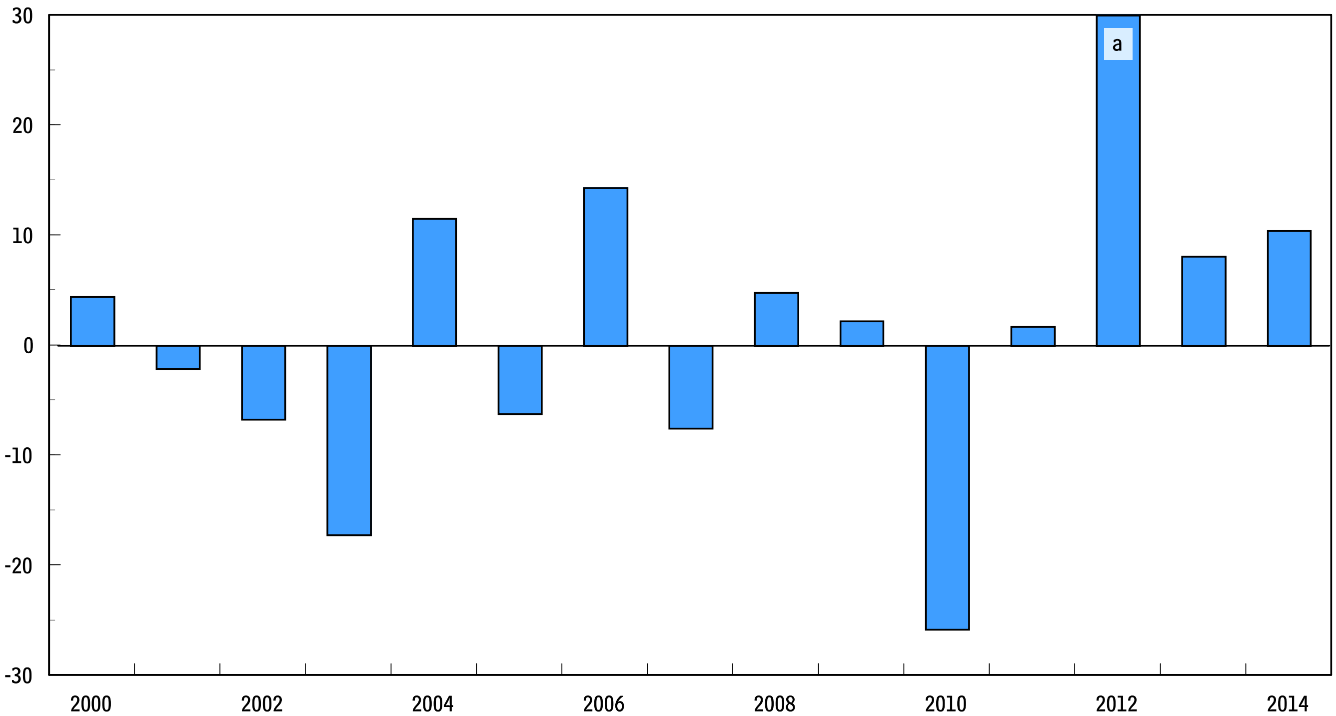
Other Sources of Revenue

Customs duties and numerous miscellaneous receipts bring in much smaller amounts of revenue than the major levies do. CBO estimates that those revenues will remain fairly steady as a share of GDP—at just above 0.5 percent—throughout the projection period. That share will be slightly lower in the first few years, however, because of the effect of low short-term interest rates on the Federal Reserve System's earnings.

Figure 4-5.

Estate and Gift Tax Receipts

(Percentage change from previous year)



Source: Congressional Budget Office.

a. The projected value in 2012 is 102 percent.

CBO projects that customs duties will grow over time in tandem with imports. During the next few years, however, their growth will be curbed as tariff reductions enacted in 1994 are phased in. Some slight decline in customs receipts relative to output occurs because petroleum, an important component of overall imports, is assessed a specific duty that does not rise with price. Projections of customs duties are slightly higher now than in August, due to changes in the economic forecast.

Profits of the Federal Reserve System—the largest component of miscellaneous receipts—are counted as revenues once they are turned over to the Treasury *(see Table 4-9).* Those profits depend on the interest that the Federal Reserve earns on its portfolio of securities and on gains and losses from its holdings of foreign currency. In the past three years, earnings on securities have declined as the Federal Reserve lowered interest rates to stimulate economic growth and counter the economy's downturn. In addition, the recession and slow recovery curbed the growth of the Federal Reserve's portfolio of assets because of slower growth in the public's holdings of U.S. currency. Those factors have led CBO to project that receipts from the Federal Reserve System this year will be substantially below the average of recent years. However, the central bank's income—and therefore the receipts it remits to the Treasury—are expected to return to their previous pattern in 2005 and 2006.

Since August, expectations of lower inflation and interest rates have led CBO to reduce its projection of Federal Reserve receipts by about $26 billion over the 2004-2013 period. Technical revisions in other miscellaneous receipts—largely the result of unexpected recent collections—offset that reduction by about $2 billion.

The Effects of Expiring Tax Provisions

CBO's revenue projections rest on the assumption that current tax laws remain unaltered except for scheduled changes and expirations, 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.

The assumption that tax provisions expire as scheduled can have a significant impact on CBO's estimates—even in ordinary circumstances, when those provisions do not include such large changes as the personal tax cuts in EGTRRA and JGTRRA or the partial-expensing rules enacted in JCWAA and extended in JGTRRA. Many expiring provisions are extended almost as a matter of course, and most of them reduce receipts. Thus, revenue projections that assumed the extension of those provisions would be lower than revenue estimates projected under current law. To provide as complete an outlook for revenues as possible, this section details the various tax provisions whose expiration is reflected in CBO's projections, and the revenue effects of extending them.

The estimates of revenue associated with the extensions cited in this section do not include any effects of the provisions on the macroeconomy. In many instances, macroeconomic feedbacks would be too small to have a substantial effect on the estimates. Among the expirations, however, are the EGTRRA and JGTRRA rate cuts that influence labor supply and growth in CBO's baseline economic projection. Hence, the full "dynamic" revenue effect of extending some of these provisions would differ from the estimates presented in this section.

Provisions That Expired in 2003

Seventeen tax provisions expired at the end of 2003, of which 16 reduce revenues *(see Table 4-10 on page 92).* Most of them had been set to expire before and were extended temporarily, in some cases numerous times, even retroactively following expiration. If all 16 of the revenue-reducing provisions were reinstated immediately and made permanent, revenues would be $85 billion lower over the 2005-2014 period.

One other provision that affects revenues also expired at the end of 2003. It is a provision enacted in 2002 that raises the interest rate that firms use to calculate their required contributions to defined-benefit pension plans and their premium payments to the Pension Benefit Guaranty Corporation, both of which are tax-deductible. If the provision were reinstated and made permanent, revenues would rise initially but decline by $7 billion during the 2005-2014 period.

Provisions That Expire During the Projection Period

A number of additional provisions will expire during CBO's current projection period. The most significant of those from a budgetary perspective are the provisions enacted in EGTRRA and JGTRRA. As described previously, several JGTRRA provisions (some of which modify EGTRRA) expire at the end of 2004, and additional provisions expire after 2008. Also, two provisions established by EGTRRA are set to expire by the end of 2006; the rest, which represent the bulk of the law's budgetary effects, expire on December 31, 2010. If all of those measures were extended, revenues would be about $2 trillion lower through 2014, CBO and the Joint Committee on Taxation (JCT) project. About two-thirds of that reduction would occur from 2011 through 2014. Revenue losses from those extensions would increase sharply after 2010, largely as a result of extending the EGTRRA tax cuts that would otherwise expire at the end of 2010. Those cuts include decreases in marginal tax rates for individuals, increases in the child tax credit, and repeal of the estate tax.

About one-third of the revenue loss from extending the expiring provisions of EGTRRA and JGTRRA would occur before 2011. Four major provisions of JGTRRA are reduced in 2005 from their full 2004 value: the child tax credit, the expanded 15 percent tax bracket and standard deduction, the expanded 10 percent tax bracket, and the increased AMT exemption. In addition, the partial-expensing provisions expire after 2004, the Section 179 expensing provisions expire after 2005, and the reduced tax rates on capital gains and dividends expire after 2008. Immediately extending the changes to estate and gift taxes enacted in EGTRRA, which expire at the end of 2010, could reduce revenues as early as this year. The reason is that if taxpayers knew that the repeal of the estate tax would become permanent in 2011, some might postpone taxable gifts that they would otherwise have made during this decade.

CBO's and JCT's estimates of the effects of extending expiring provisions also incorporate the assumption that the higher exemption levels for the AMT, which expire after 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 now scheduled. 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).

Sixteen provisions not related to EGTRRA or JGTRRA end between 2004 and 2009; 11 of them would reduce revenues if extended. The provision with the largest effect is the research and experimentation tax credit, which was enacted in 1981. In 1999, the Congress extended that tax benefit through June of this year, for the ninth and longest time. Continuing the credit through 2014 would reduce revenues by almost $50 billion. In all, extending those 11 revenue-reducing provisions would decrease receipts by $116 billion from 2005 through 2014.

Five provisions that expire over the next decade would increase revenues if they were extended. The provision with the largest effect is the Federal Unemployment Tax Act surcharge, which would increase revenues by $10 billion between 2008 and 2014, if extended. The other provisions include assessing fees for the reclamation of abandoned mines; allowing the Internal Revenue Service (IRS) to impose fees on businesses for providing ruling, opinion, and determination letters; allowing employers to transfer excess assets in defined-benefit pension plans to a special account for retirees' health benefits; and providing authority to the IRS for certain undercover operations. Extending the mine reclamation fees would raise about $250 million per year. The other three provisions would each raise less than $50 million annually.

Expiring Provisions That Are Included in CBO's Baseline

Budget rules require CBO to include in its projections excise tax receipts earmarked for trust funds, even if provisions for those taxes are scheduled to expire. The largest such taxes that are slated to expire during the next 10 years finance the Highway Trust Fund. Some of the taxes for that fund are permanent, but most of them end on September 30, 2005. Extending them at today's rates contributes about $38 billion to CBO's revenue projections in 2014, or about 40 percent of that year's total excise tax receipts.

Other expiring trust fund taxes, if extended, would account for smaller amounts in 2014, CBO estimates. Taxes dedicated to the Airport and Airway Trust Fund, which are scheduled to expire at the end of 2007, would contribute about $16 billion to revenues in 2014. Taxes for the Leaking Underground Storage Tank Trust Fund, set to end on March 31, 2005, would contribute about $275 million. No other expiring tax provisions are automatically extended in CBO's projections.

Total Effect of Expiring Provisions

If all of the expiring tax provisions were extended together, the revenue projection for 2005 would be $65 billion lower. That revenue loss would grow to $134 billion in 2006 and $158 billion in 2010, before jumping to $287 billion in 2011 and then reaching $429 billion in 2014. Over the entire 2005-2014 period, revenues would be reduced by about $2.3 trillion. That estimate of the effects of jointly extending the expiring provisions includes interactions among the provisions. Two AMT provisions in particular—increasing the exemption amount for the AMT and allowing personal credits to reduce AMT liability—interact with each other and with provisions that affect personal tax rates.

A more limited measure of the effects of extending expiring provisions would not include the partial-expensing provision. It expires at the end of 2004 and was not intended to be permanent. If all provisions except partial expensing were extended permanently, federal revenues would be about $1.85 trillion lower through 2014.

Table 4-10.

Effect of Extending Tax Provisions That Will Expire Before 2014

(Billions of dollars)

Tax Provision	Expiration Date	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Provisions That Expired in 2003														
Archer Medical Savings Accounts	12/31/03	*	*	*	*	*	*	*	*	*	*	*	*	*
Brownfields Remediation	12/31/03	-0.1	-0.3	-0.3	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.2	-2.1
Corporate Contributions of Computers to Schools	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.7	-1.7
Credit for Electric Vehicles	12/31/03	*	*	*	*	*	*	*	*	*	*	*	*	*
Credit for Electricity Production from Renewable Sources	12/31/03	*	*	-0.1	-0.2	-0.3	-0.5	-0.8	-1.1	-1.5	-1.9	-2.2	-1.2	-8.7
Deduction for Teachers' Classroom Expenses	12/31/03	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-0.2	-1.1	-2.2
Deductions for Clean-Fuel Vehicles and Refueling Property	12/31/03	*	-0.1	-0.2	-0.4	-0.5	-0.4	-0.4	-0.4	-0.3	-0.1	-0.1	-1.6	-2.8
Interest Rate for Pension Calculations	12/31/03	4.8	3.7	1.6	0.6	-1.3	-2.2	-2.6	-2.0	-1.9	-2.0	-1.3	2.5	-7.3
Net Income Limitation for Marginal Oil and Gas Wells	12/31/03	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.5
Qualified Zone Academy Bonds	12/31/03	*	*	*	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.6
Reduction in Policy-holder Dividends for Insurance Companies	12/31/03	*	*	*	*	*	*	*	*	*	*	*	-0.2	-0.4
Rum Excise Tax Revenue to Puerto Rico and the Virgin Islands	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.4	-0.8
Tax Incentives for Investment in the District of Columbia	12/31/03	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.2	-0.2	-0.2	-0.2	-0.3	-0.5	-1.5
Treatment of Personal Credits Under AMT	12/31/03	-0.1	-0.6	-2.3	-3.6	-4.2	-4.8	-5.5	-6.1	-7.4	-8.5	-9.2	-15.5	-52.1
Welfare-to-Work Tax Credit	12/31/03	*	*	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.7
Work Opportunity Tax Credit	12/31/03	-0.1	-0.2	-0.3	-0.3	-0.3	-0.4	-0.4	-0.4	-0.4	-0.5	-0.5	-1.5	-3.7
Tax Incentives for Areas of New York City Damaged on Sept. 11	Various[a]	-0.1	-0.3	-0.3	-0.7	-0.9	-0.8	-0.8	-0.8	-0.8	-0.8	-0.8	-3.0	-6.9
Provisions That Expire Between 2004 and 2014														
Credit for Research and Experimentation	06/30/04	-0.5	-2.8	-3.2	-3.7	-4.1	-4.6	-5.1	-5.6	-6.2	-6.7	-7.2	-18.4	-49.2
Abandoned Mine Reclamation Fees	09/30/04	n.a.	0.2	0.2	0.2	0.2	0.2	0.3	0.3	0.3	0.3	0.3	1.2	2.5
Depreciation for Business Property on Indian Reservations	12/31/04	**	-0.1	-0.4	-0.5	-0.5	-0.5	-0.4	-0.3	-0.3	-0.3	-0.3	-2.1	-3.6
Increased AMT Exemption Amount	12/31/04	n.a.	-7.1	-20.3	-26.8	-34.2	-42.8	-50.5	-42.0	-25.5	-30.6	-35.5	-131.1	-315.2
Indian Employment Tax Credit	12/31/04	n.a.	*	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.1	-0.3	-0.8
IRS User Fees	12/31/04	n.a.	**	**	**	**	**	**	**	**	**	**	0.2	0.4
Partial Expensing at 50 Percent	12/31/04	3.1	-41.4	-71.1	-66.2	-57.5	-48.4	-39.8	-33.0	-28.2	-26.0	-28.4	-284.6	-440.1

(Continued)

Table 4-10.

Continued

(Billions of dollars)

Tax Provision	Expiration Date	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Total, 2005-2009	Total, 2005-2014
Authority for Undercover IRS Operations	12/31/05	n.a.	n.a.	**	**	**	**	**	**	**	**	**	**	**
Deduction for Qualified Education Expenses	12/31/05	n.a.	n.a.	-2.6	-3.6	-3.9	-4.2	-4.4	-3.9	-3.9	-4.0	-4.0	-14.4	-34.6
Puerto Rico Business Credits	12/31/05	n.a.	n.a.	-0.6	-1.4	-1.5	-1.6	-1.7	-1.9	-2.0	-2.2	-2.3	-5.1	-15.2
Section 179 Expensing	12/31/05	n.a.	n.a.	-3.6	-6.2	-4.8	-3.9	-3.3	-2.8	-2.6	-2.5	-2.6	-18.5	-32.3
Transfer of Excess Assets in Defined-Benefit Plans	12/31/05	n.a.	n.a.	**	**	**	**	**	**	**	**	**	0.1	0.3
Andean Trade Preference Initiative	12/31/06	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	-0.1	-0.3
Credit for IRA and 401(k)-Type Plans	12/31/06	n.a.	n.a.	n.a.	-0.6	-1.9	-1.7	-1.6	-1.4	-1.4	-1.3	-1.1	-4.1	-10.9
Depreciation for Clean-Fuel Automobiles	12/31/06	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*	-0.1
Generalized System of Preferences	12/31/06	n.a.	n.a.	n.a.	-0.4	-0.6	-0.6	-0.7	-0.7	-0.7	-0.8	-0.8	-1.6	-5.3
Subpart F for Active Financing Income	12/31/06	n.a.	n.a.	n.a.	-0.9	-2.8	-3.1	-3.5	-4.0	-4.4	-4.9	-5.3	-6.8	-28.9
Alcohol Fuels Income Credit	12/31/07	n.a.	n.a.	n.a.	n.a.	*	*	*	*	*	*	*	*	*
FUTA Surtax of 0.2 Percentage Points	12/31/07	n.a.	n.a.	n.a.	n.a.	1.0	1.4	1.5	1.5	1.5	1.5	1.5	2.5	9.9
New Markets Tax Credit	12/31/07	n.a.	n.a.	n.a.	n.a.	-0.1	-0.3	-0.4	-0.6	-0.8	-1.0	-1.2	-0.4	-4.6
Reduced Tax Rates on Dividends and Capital Gains	12/31/08	n.a.	n.a.	n.a.	n.a.	-2.3	-12.8	-25.7	-34.9	-39.7	-41.7	-44.0	-15.1	-201.1
Empowerment and Renewal Zones	12/31/09	n.a.	n.a.	n.a.	n.a.	n.a.	n.a.	-0.8	-1.6	-1.7	-1.9	-2.0	0	-8.1
Estate and Gift Tax Changes	12/31/10	-0.5	-0.9	-1.1	-1.5	-1.9	-1.7	-2.4	-29.0	-51.0	-55.3	-60.8	-7.2	-205.6
Other Provisions of EGTRRA and JGTRRA[b]	Various[b]	n.a.	-12.9	-25.2	-23.1	-19.0	-15.8	-10.4	-103.3	-176.5	-179.8	-182.2	-96.1	-748.2
						All Expiring Provisions								
Interaction from Extending All Provisions Together		0	-1.5	-3.2	-1.8	0.2	2.4	2.9	-11.4	-32.5	-34.6	-37.0	-3.9	-116.5
Total		**6.0**	**-64.9**	**-133.6**	**-141.9**	**-142.1**	**-148.1**	**-157.6**	**-286.7**	**-389.2**	**-406.7**	**-428.6**	**-630.7**	**-2,299.5**

Sources: Joint Committee on Taxation; Congressional Budget Office.

Notes: * = between -$50 million and zero; ** = between zero and $50 million; n.a. = not applicable; 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; JGTRRA = Jobs and Growth Tax Relief Reconciliation Act of 2003.

These estimates assume that the expiring provisions are extended immediately rather than when they are about to expire and that provisions that have already expired are reinstated immediately.

The provisions are assumed to be extended at the rates or levels existing at the time of expiration. These estimates do not include debt-service costs.

When this report went to press, JCT's estimates based on the new economic projections were unavailable for most expiring provisions related to EGTRRA's and JGTRRA's individual income tax provisions and the AMT. For the two expiring AMT provisions, CBO updated JCT's previous estimates for the estimated effects of the changed economic projections. Estimates of provisions combined in the entry for "Other Provisions of EGTRRA and JGTRRA" have not been updated, although they were extended to 2014. JCT's updated estimates will be made available when they are completed. JCT has updated the estimates of provisions of EGTRRA and JGTRRA that are shown as separate entries and all other provisions except those for the AMT.

a. The provision that expands the work opportunity credit in New York City expired on 12/31/2003. The provisions that increase expensing under Section 179 and allow a five-year lifetime for leasehold improvements expire on 12/31/2006. The provisions related to partial expensing for property placed in service expire on 12/31/2006 and 12/31/2009.

b. These provisions affect several rates, brackets, credits, and other parameters for individual income taxes: the child tax credit; 10 percent rate bracket; 15 percent rate bracket and standard deduction for joint filers; 25 percent and higher tax rates; the phaseout of limitations on itemized deductions and personal exemptions; and certain education, pension, and other provisions. All of the provisions as enacted in EGTRRA expire at the end of 2010. Modifications enacted in JGTRRA expire at the end of 2004. The estimates do not include the deduction for qualified education expenses, the credit for IRA and 401(k)-type plans, reduced rates on dividends and capital gains, and the exemption amount for the AMT, which are shown in separate entries.