Taxing some fringe benefits, such as small employee discounts, would involve collection costs greater than the revenue to be collected; but larger items could be taxed cost-effectively. In all likelihood, some fringe benefits would be converted to cash income by mutual agreement of employers and employees; this would add to tax revenues in the same way as the direct taxation of fringe benefits.

TIGHTEN THE MEDICAL EXPENSE DEDUCTION
(B-550-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.4	3.0	3.2	3.5	3.8	13.9

The 40 percent of taxpayers who itemize may claim as deductions all out-of-pocket medical expenses that in total exceed 3 percent of adjusted gross income, as well as one-half of health insurance premiums up to $150. Raising the threshold for the medical expense deduction to 10 percent and eliminating the separate deductibility of health insurance premiums would add $13.9 billion to revenues over the next five years.

The deductibility of medical expenses above 3 percent of adjusted gross income has been justified on the ground that it assists people with extraordinary and involuntary expenses. The deduction is not limited to involuntary expenses, however; it also covers the cost of cosmetic surgery, expensive rest cures, and other optional expenses. In fact, with the substantial expansion of health insurance coverage in recent years, a significant share of the out-of-pocket medical expenses now deducted are for procedures that are not generally reimbursed by insurance because they are highly discretionary. The deduction has also been criticized because it provides a larger, rather than a smaller, subsidy rate the higher a person's income.

The basic argument for increasing the threshold for the medical expense deduction is that, if the income tax system is to be used to shift part of a person's health care costs to the federal Treasury, the relief ought to be confined to taxpayers with genuine financial need. Currently, 58 percent of taxpayers with incomes in excess of $100,000 claim the medical expense deduction compared with 8 percent of those with incomes below $10,000. The average reduction in taxes for those with incomes below $10,000 was about $60 in 1981 compared with $560 for those with incomes above $100,000.

The separate deduction for health insurance premiums was adopted to encourage the purchase of health insurance; however, there is no evidence that it has had this effect. Like the medical expense deduction, it provides greater tax savings to taxpayers with higher incomes, who have less need for assistance in purchasing insurance than those with lower incomes.

TAX SOME EMPLOYER-PAID HEALTH INSURANCE
(B-550-b)

Addition to CBO Baseline	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Income tax	2.0	3.4	4.2	5.0	6.0	20.6
Payroll tax	0.6	1.1	1.4	1.7	2.0	6.8

Employees do not pay taxes on income received in the form of employer-paid health care coverage. The exclusion will reduce 1983 income tax revenues by about $18 billion--an amount comparable to total federal spending for Medicaid, the major program financing health care services for the poor. This form of income also escapes payroll taxation, costing the Social Security trust fund about $8 billion in lost 1983 revenues.

One proposal for limiting the present exclusion would treat as taxable income any portion of employer contributions exceeding $150 a month for family coverage and $60 per month for individual coverage in 1983, with the amount indexed to medical care prices. This is similar to the approach already adopted by the Congress in connection with employer-provided group life insurance. The proposal would raise income tax revenues by $2.0 billion and payroll tax revenues by $0.6 billion in 1983. Over the 1983-1987 period, the revenue increases would amount to $20.6 billion and $6.8 billion, respectively. Any "grandfathering" of existing contributions would reduce these revenue increases.

In 1983, such a limitation would affect about 40 percent of those who participate in employer-sponsored health insurance plans. Similar limitations were included in a number of bills introduced in the 97th Congress, but none was acted on.

Both health-policy and tax-policy arguments have been made for limiting this exclusion. The exclusion leads to what many consider to be overly extensive health insurance coverage, which has expanded use of health care services unnecessarily and, consequently, driven up their prices. Moreover, the provision disproportionately benefits persons with higher incomes, both because they tend to have larger employer-paid health insurance premiums that are excluded from taxation and because they are in higher marginal tax brackets.

Opponents of taxing any portion of employer-paid health insurance argue that present health insurance coverage is not excessive and that changing the current policy would result in less insurance coverage; this might, in turn, cause some people to forgo important medical care. Also, they argue that a uniform ceiling would have uneven effects, since a given employer contribution purchases differing levels of coverage depending on several factors such as geographic location and the demographic characteristics of the firm's work force.

ELIMINATE TAX-EXEMPTION FOR PRIVATE HOSPITAL BONDS
(B-550-c)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.1	0.3	0.5	0.8	1.1	2.8

The volume of tax-exempt bonds used to finance private hospital construction increased from $3.6 billion in 1980 to $5.1 billion in 1981, accounting for approximately 9 percent of all new long-term tax-exempt financing in that year. Approximately half of all new hospital construction is financed with tax-exempt bonds. Eliminating the tax exemption would increase federal revenues by about $2.8 billion in the 1983-1987 period.

The necessity of providing subsidies for new hospital construction has come into question because at present the United States has a surplus of hospital beds. In consequence, direct federal subsidies for hospital construction have been cut back sharply in recent years.

The main argument against repealing the tax exemption for private hospital bonds is that, although nationally the supply of hospital beds may be more than sufficient, some areas still lack adequate hospital facilities. A possible solution might be to target tax-exempt hospital bonds on areas that have a shortage of adequate facilities. It can be argued, however, that tax-exempt financing is not the best way to assist such areas. Direct subsidies may be a less expensive and more efficient alternative, since the entire subsidy would then go to the institution; with tax-exempt bond financing, as much as a third of the subsidy goes to bondholders, underwriters, and bond counsel. Direct subsidies would also help to relieve the pressures on the municipal bond market, where rates have in some instances climbed high enough to erode almost completely the savings usually realized from tax exemption.

INCREASE MEDICARE PART B PREMIUMS
(B-550-d)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.0	1.5	2.1	2.8	3.7	11.0

Part B of the Medicare program, Supplementary Medical Insurance, covers a variety of medical expenditures including physicians' services and outpatient care. Participation is voluntary. Enrollees pay a monthly premium, now $11.00 but scheduled to rise to $12.20 on July 1, 1982. The remaining costs of the program are covered by an appropriation ($13.3 billion in 1982) from general revenues.

Premium receipts have covered a declining share of Part B costs each year--falling from 50 percent in 1972 to 25 percent in 1981. Under current policies, the share of costs covered by the premium will drop to 18 percent by 1987. The decline in the enrollees' contribution results because the formula for calculating premium increases reflects the previous year's increase in Social Security retirement rather than the per capita costs of Part B.

If the premium was set so that participants paid 30 percent of incurred costs per aged enrollee beginning October 1, 1982, net savings would total $0.9 billion in 1983 and $9.9 billion over the five-year period. These amounts are lower than the totals in the table since this option would also result in outlay increases in Medicaid. The estimated monthly premium would be $14.70, up $2.50 from the rate taking effect three months earlier.

This option would reduce a federal subsidy that has grown to be larger than originally planned. It should not affect the poorest of the elderly and disabled since they are likely eligible for Medicaid, which usually pays the Part B premium on their behalf. On the other hand, some elderly and disabled persons would still find the increased premiums burdensome and medical costs would consume an ever-increasing share of the budgets of Medicare participants. Some might drop Part B coverage and either do without medical care or turn to sources of free or reduced-cost care, increasing the demands on local governments.

IMPOSE A PREMIUM TAX ON PRIVATE INSURANCE
THAT SUPPLEMENTS MEDICARE
(B-550-e)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	2.5	3.0	3.5	4.0	4.7	17.7

The Medicare program requires beneficiaries to share in some of the costs of care. Part A Hospital Insurance requires a one-day deductible and some coinsurance for hospitalization and skilled nursing care. In addition, it limits the number of days of insured hospitalization during a spell of illness. Part B, Supplementary Medical Insurance (mainly for physician care), also has a deductible of $75 a year, and the patient must pay at least 20 percent of charges above the deductible.

In order to reduce their out-of-pocket payments for deductibles and coinsurance, approximately 55 percent of all Medicare participants purchase (or receive from employers) private coverage to supplement Medicare. Such insurance is often called "Medigap." The plans vary widely but often pay all the cost-sharing portions of Medicare. Persons with Medigap coverage use services at a higher rate--estimated at 7 to 10 percent of Medicare costs--than those who have only the Medicare benefit package. Yet Medicare pays most of the costs of the additional use of services (for example, 80 percent of physicians' reasonable charges).

The option discussed here would recoup the extra federal outlays arising from supplemental coverage by imposing a 35 percent premium tax on Medigap policies that pay any part of the first $1,000 of Medicare cost-sharing. This proposal would not affect insurance protection for unusually large health costs. Federal savings would stem both from the premium tax receipts and from a reduction in health care use by those who would drop Medigap coverage because of the increase in its cost. Revenues could be allocated to the two Medicare trust funds on a proportional basis.

Savings would total $2.5 billion in 1983 and $17.7 billion over the 1983-1987 period. The table attributes the entire savings to increased revenues; in actuality the savings would be split between outlay decreases and revenue increases.

This option would lead to more equal government aid for all participants by requiring those with Medigap coverage to bear the additional costs they impose on the Medicare system. Elderly and disabled persons with the lowest incomes would not be affected, for they have no reason to buy Medigap coverage; their deductibles and coinsurance are paid by Medicaid.

On the other hand, the Medigap premium tax would discourage the purchase of supplemental coverage. Some who would otherwise have purchased it would face difficulties in meeting out-of-pocket costs during a year of unusually high medical expenditures.

REPEAL THE CASUALTY LOSS DEDUCTION
(B-600-a)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.1	0.9	1.0	1.1	1.2	4.3

Under current law, taxpayers who itemize their deductions may deduct losses caused by fire, storm, shipwreck, or other casualty, or theft, to the extent that the taxpayer is not reimbursed for the loss through insurance, disaster assistance, or other compensation. In 1964, the Congress limited the deduction to the amount of each loss in excess of $100.

If the deduction was repealed, revenue would increase by about $130 million in 1983 and by about $4.3 billion during 1983-1987.

The main argument for allowing the deduction is that taxpayers who suffer large, unpredictable, and unavoidable losses of personal property have a diminished ability to pay their federal income taxes and should thus be granted some financial assistance. Because the flow of services produced by these personal assets is not taxed, however, it is theoretically not correct to allow a deduction for the losses.

The present system has three drawbacks: it is difficult to administer, it provides an uneven kind of disaster assistance, and it creates perverse incentives. The deduction is difficult to administer because defining and valuing a casualty loss is inherently difficult. Luxury items such as jewelry, furs, and silver are included in the definition, although their loss probably does not diminish an individual's ability to pay tax. A deduction is allowed only for sudden and unexpected losses, so that two taxpayers who suffer the same final loss and hence the same diminished ability to pay tax may be treated differently depending on the suddenness of the losses. A deduction is allowed, for instance, for ornamental shrubs struck by lightning but not for the same shrubs lost gradually to winterkill.

The deduction provides an uneven disaster assistance subsidy because the assistance is granted only to those who itemize their deductions, and the amount of the assistance for a given loss increases with the taxpayer's marginal tax rate.

Finally, the current system discourages some taxpayers from taking precautions of their own against disaster--encouraging them to buy less insurance than they otherwise might.

An alternative to outright repeal would be to establish a higher floor for the deduction. Raising it from $100 to $300 would simply be an adjustment for the inflation that has occurred since 1964, and would cut the projected revenue loss by about $150 million a year.

ELIMINATE EXTRA TAX EXEMPTION FOR THE ELDERLY AND BLIND (B-600-b)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.8	2.4	2.5	2.7	2.8	11.2

Any taxpayer 65 or older or blind is permitted to claim an extra $1,000 exemption. The most widely perceived reasons for this feature of the tax law are the lower income and extra costs of living (especially medical costs) of the aged and blind. Repeal of the extra exemption would increase revenues by $0.8 billion in 1983, and by $11.2 billion during 1983-1987. Only about 15 percent of the elderly with incomes below $7,000 would suffer tax increases, averaging about $150; the average tax increase for all elderly taxpayers would be about $275.

The extra exemption is criticized on several grounds. Neither age nor blindness is itself proof of financial need; more than one-third of all 1978 tax returns with adjusted gross income of at least $1 million claimed an extra exemption for age. Other taxpayers with handicaps are not favored with an extra exemption. The elderly and blind who are in fact faced with extraordinary medical expenses can deduct them, so the extra exemption is not needed for that purpose. Because the exemption saves more tax dollars for those in the highest tax brackets, 17 percent of the tax saving goes to the 7.6 percent of all elderly and blind taxpayers with incomes of over $50,000. The elderly and blind with the lowest incomes are not taxable and do not benefit from the extra exemption; in 1978 only 11 million extra exemptions were claimed by 24 million elderly Americans.

As an alternative to outright repeal, the Congress could convert the extra exemption to a $150 credit. Elderly and blind couples with incomes under $11,600 in 1983, and single persons with incomes under $6,400, would be better off with such a credit; and those with higher incomes would at least get the $150 tax saving. Converting the exemption to a $150 credit would increase tax revenues by $0.4 billion in 1983, and by $4.0 billion through 1987.

TAX HALF OF RETIREMENT BENEFITS FOR SOCIAL SECURITY RECIPIENTS WITH INCOMES ABOVE $20,000/$25,000 (B-600-c)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.6	1.9	2.3	2.7	3.1	11.6

Social Security benefits (and most other government transfer payments) are not subject to personal income taxation. Treating half of Social Security workers' retirement benefits as taxable income for couples with incomes above $25,000 (and single individuals with incomes above $20,000) would increase revenues by about $1.6 billion in 1983 and by nearly $12 billion in 1983-1987.

The law nowhere specifies that Social Security benefits are to be tax-free; benefits have been excluded from taxation only on the basis of an Internal Revenue Service ruling at the start of the program that they were in the nature of welfare payments. (At the time, most recipients were classified as poor.)

There are several arguments for taxing half of retirement benefits for recipients with incomes above $20,000/$25,000 (which is also the current treatment of unemployment compensation). Aside from raising revenue to reduce the budget deficit, the proposal would bring the tax treatment of Social Security payments partly into line with other pension benefits, which are fully taxable after the retiree has recovered his own contributions, if any. If Social Security were taxed like private pensions, about 83 percent of retirement benefits would be taxable.

Taxing benefits would also have the advantage of improving intergenerational equity. Current Social Security recipients generally receive benefits well in excess of their past contributions, with the extra amount being financed by the taxes on the present generation of workers. The extra income tax revenues generated by the provision could be directed to the OASI fund, thereby easing the tax burden on current workers. Over the longer run, taxing benefits would probably also ease the Social Security system's financial problems by inducing individuals to work longer over their lifetimes, since after-tax retirement incomes would be reduced. Setting the threshold amounts at $20,000/$25,000 would limit the proposal's effects to those beneficiaries with the greatest ability to pay.

COVER NEW GOVERNMENT EMPLOYEES UNDER SOCIAL SECURITY
(B-600-d)

Addition to CBO Baseline	Annual Added Revenues (billions of dollars) 1983	1984	1985	1986	1987	Cumulative Five-Year Addition
Social Security Trust Funds	0.6	2.0	3.7	5.5	7.4	19.2
Total Revenues a/	0.3	1.1	2.0	3.0	4.0	10.4

a. Represents net increases in total federal revenues assuming that new federal employees make no contribution to the Civil Service Retirement trust fund.

Government employment accounts for the largest portion of the nation's work-force not covered by Social Security; the jobs of more than 90 percent of federal workers and about 30 percent of state and local employees are not covered. If all new government employees were covered beginning January 1, 1983, Social Security net trust fund balances would improve in both the short and the long run. Over the next five years, trust fund revenues would increase by approximately $19 billion.

The eligibility requirements for Social Security and for government pensions based on noncovered employment permit many workers to qualify for both. A frequent result is that government retirees receive the advantage of features in the Social Security benefit formula that provide higher relative benefits to workers with low earnings, even though such government retirees do not actually have histories of low earnings. Mandatory coverage would end this anomaly. It would also improve disability and survivor protection for younger government employees and those who change jobs, because the vesting period for these benefits under Social Security is shorter than under most government pensions, and because Social Security coverage is more portable.

One problem that arises with Social Security coverage of new government employees is the integration of Social Security with existing government pension programs. For example, new federal employees would probably not be required to pay both the current 7 percent contribution rate for Civil Service Retirement (CSR) and 6.7 percent for Social Security. Whether or not CSR coverage for new employees would be contributory is an issue that would have to be resolved. Income to the CSR trust fund, however, would be substantially reduced under virtually all the Social Security coverage options for federal workers considered to date.

Opponents of mandatory coverage of new government employees point to several other difficulties in this proposal. First, the present system makes public employee pension programs attractive fringe benefits that may help the recruitment and retention of civil servants. Second, it is argued that mandatory coverage, by generating substantial new revenues for Social Security, would only delay more fundamental reforms of the Social Security program. Finally, the different treatment of new employees might create inequities between workers under the new and old pension systems.

TAX WORKERS' COMPENSATION BENEFITS
(B-600-e)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.5	3.8	4.5	5.5	6.7	22.0

Most workers who suffer on-the-job injuries are insured by workers' compensation. Payments are tax free and cover medical expenses and some portion of income loss. If the payments for income loss were taxed beginning in 1983, the revenue gain would be $1.5 billion in 1983 and $22.0 billion during 1983-1987.

By far the costliest part of workers' compensation is benefits for permanent partial impairment from work-related injury. Assessment of the degree of disability is necessarily inexact, and may or may not correspond to actual income loss. In some cases, it is likely that the value of the tax-free benefits exceeds the lost wages net of tax; in those cases, beneficiaries have little incentive to return to work. It is arguably unfair when one person receives tax-free workers' compensation while another earns equal amounts in wages but must pay tax.

These problems can be ameliorated through taxation of workers' compensation benefits that substitute for wages. Beneficiaries who suffer reductions of income will be protected from taxation by the standard or medical expense deductions and the personal exemption, while others who have more substantial benefits and delay their return to work will have their net compensation reduced.

Opponents of such a policy change would argue that benefit levels differ significantly from state to state, and hardships might result if low-benefit states did not increase their benefits to take account of the tax on them. Further, some beneficiaries would be subject to higher marginal tax rates than others solely because they had working spouses. Finally, because court-awarded damages for income loss due to non-workplace injuries are not subject to tax, it could be argued that it is unfair to subject similar payments to tax in the case of workplace injuries.

TAX RAILROAD RETIREMENT BENEFITS
(B-600-f)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	0.2	0.2	0.2	0.2	0.2	1.0

The Railroad Retirement System (RRS) is an industry-wide pension plan. It currently pays benefits to nearly one million annuitants and provides mandatory coverage for about 500,000 workers employed by 1,000 different railroad companies. Railroad retirement predates and remains independent of the Social Security program, although the two systems now have many common features and coordinate their coverage. Unlike any other private pension, RRS is managed by the federal government, and the retirement income it provides is almost entirely tax free. 1/ If the benefits were taxed like private-sector pensions, federal revenues would increase by about $1.0 billion in the 1983-1987 period.

Since 1975, RRS has been structured to parallel the two-part retirement income available to employees in the rest of the private sector: a Tier I component that both substitutes for Social Security coverage and provides certain extra benefits, and a Tier II component that compares to an employer pension and may be supplemented by longevity payments. If RRS benefits were taxed like private-sector pensions, the Social Security portion would be tax-free, but both the "extra" benefits under Tier I and the Tier II employer pension component would be taxable to the extent that benefits exceed employee contributions. Although determining the appropriate tax for each RRS annuitant would be administratively difficult, approximately the same revenue increase would be

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1. The only benefits subject to federal income tax are supplemental longevity payments for retirees with the equivalent of 25 or more years railroad service. These benefits began in 1966 and cannot exceed $840 a year. No taxes would be collected, however, unless an RRS annuitant, under age 65, had taxable income exceeding $3,300 if single and $5,400 if married and filing a joint return.

achieved by taxing 40 percent of each RRS pension. If some portion of Social Security benefits were taxed as suggested in item B-600-c, it might be appropriate to tax a larger share of RRS benefits.

The cost of this option would, of course, fall on railroad annuitants. In calendar year 1983, for example, married railroad annuitants--with RRS pension benefits ranging between $20,000 and $22,000--will otherwise receive an income tax advantage averaging some $1,200 per couple. 2/ If this proposal were enacted, this tax advantage would shrink; nonetheless, for married annuitants who are newly retired, RRS would still offer after-tax benefits that appear among the highest in private industry. Low-income annuitants would be liable for little if any additional tax payment because of the graduation of the federal income tax system.

Proponents of this option would argue that the current exclusion of practically all RRS benefits from taxable income is an historical anomaly. Treating some benefits as comparable to Social Security, and thus nontaxable, would be fair, they argue, but to exclude the remainder, which is comparable to the taxable benefits paid from other employer pension plans, is inequitable and not justified by sound tax principles.

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2. After a railroad retiree and his spouse both reach age 65, the tax advantage on the same income shrinks to about $900 because of the extra $1,000 tax exemption available to all taxpayers over age 65. Also, as a result of graduated income tax rates, the advantage of a tax-free RRS pension increases to the extent that a railroad annuitant has taxable income from other sources.

TAX ACCRUED INTEREST ON LIFE INSURANCE RESERVES
(B-600-g)

	Annual Added Revenues (billions of dollars)					Cumulative Five-Year Addition
	1983	1984	1985	1986	1987	
Addition to CBO Baseline	1.5	3.7	3.9	4.0	4.1	17.2

Premiums paid for whole life insurance policies can be divided into the price of death protection and a separate saving component. While death benefits paid by insurance companies approximately exhaust the death protection component of the premiums each year, the saving component builds up as a reserve or cash value that earns interest year by year.

Attributing interest on life insurance reserves to policyholders for income tax purposes on a current basis (even though they did not receive the interest in cash) would raise $1.5 billion in 1983, and $17.2 billion over the 1983-1987 period. About 25 million tax returns would be affected. The impact on the least affluent policyholders could be reduced by taxing only interest in excess of some floor, perhaps $100 a year. Such a limitation would likely reduce the revenue gain by about half.

In most respects, saving through whole life insurance is identical to saving through other interest-bearing instruments; the one major difference is that interest earned on life insurance reserves is not taxable until the policy matures. At the same time, interest paid by policyholders on their policy loans is deductible. While whole life insurance policies have until recently offered low guaranteed rates of return through conservative investments of premiums, new policies are now being offered with much higher rates of return to capitalize on this tax advantage. Policies can be tailored to allow the policyholders easy and early access to their funds, unlike tax-deferred IRA accounts where money must be deposited until retirement age to avoid stiff penalties.

Opponents of the exclusion of life insurance interest argue that life insurance companies can invest their policyholders' savings tax free, while the policyholder investing in the same assets