REV-02 AMEND OR REPEAL THE INDEXING OF INCOME TAX SCHEDULES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Suspend Indexing for 1996 (Except for the earned income tax credit)	5.7	10.3	11.9	12.5	12.9	53.3
Repeal Indexing (Except for the earned income tax credit)	5.7	16.3	29.2	43.4	58.8	153.4

SOURCE: Joint Committee on Taxation.

To offset the effects of inflation, current law each year indexes the standard deduction, the personal exemption, the minimum and maximum dollar amounts for each tax rate bracket, the thresholds for the phase-out of personal exemptions, the limit on itemized deductions, and the earned income tax credit (EITC). A repeal of indexing (except for the EITC), beginning in 1996, would raise revenues by about $153 billion from 1996 through 2000, if the annual rate of inflation averages 3.3 percent over the period, as the Congressional Budget Office projects. Revenues from the repeal would grow rapidly as the effect of repeal cumulated over time. Although suspending indexing only for 1996 would raise the same amount of revenues in the first year, it would raise much less in later years--about $53 billion over the five-year period.

An alternative to suspending or repealing indexing is to index by something less than the full annual increase in the consumer price index (CPI) that applies under current law. If the CPI tends to overstate the increase in the cost of living, as some evidence suggests, then indexing by less than the full CPI increase would be appropriate. Indexing by 0.5 percentage points less than the estimated increase in the CPI would raise revenues and reduce EITC outlays by about $11 billion per year by 2000 and by increasing amounts in subsequent years.

Repealing or suspending indexing would not burden all taxpayers equally. Among families with the same income, the tax increase would be smaller for taxpayers who itemize than for those who use the standard deduction, and for families without children than for families with children (and more personal exemptions). As long as the EITC continued to be indexed, low-income families would have a smaller percentage drop in after-tax income than other families because they have little or no taxable income. The percentage drop in after-tax income would also be small for families with the highest incomes because they receive no benefit from the personal exemption, and most of them do not take the standard deduction. A general rate increase would allocate additional taxes more equally among families with the same income than repealing or suspending indexing (see REV-01).

Another reason for retaining indexing is that it allows the Congress to decide explicitly on tax increases. Without indexing, inflation would cause the average income tax rate to increase without any legislative action.

REV-03 TAX ALL CORPORATE INCOME AT A 35 PERCENT RATE

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	1.6	3.5	3.5	3.5	3.6	15.7

SOURCE: Joint Committee on Taxation.

Under current law, corporations pay a 35 percent statutory tax rate on their taxable income in excess of $10 million. Income below that amount is subject to tax at reduced rates of 15 percent, 25 percent, and 34 percent. Eliminating the reduced corporate rates and taxing all corporate income at the single 35 percent rate would raise an estimated $15.7 billion from 1996 through 2000.

Firms with taxable income below $75,000 have tax rates of 15 percent or 25 percent. Firms with taxable income between $75,000 and $10 million have a tax rate of 34 percent, and those with income above $10 million have a 35 percent rate. Compared with a single 35 percent statutory rate, corporations with taxable income between $10 million and $15 million pay $100,000 less in taxes--the maximum benefit from the lower rates.

The tax benefit from the reduced rates is phased out for corporations with income above certain amounts by an additional 5 percent tax that is levied on corporate taxable income between $100,000 and $335,000 and a 3 percent additional tax on income between $15 million and $18.3 million. As a result, corporations with income of more than $18.3 million pay an average rate of 35 percent and receive no benefit from the reduced rates.

The Congress enacted the reduced rates to provide tax relief to small and moderate-sized businesses. Of the approximately 1 million corporations that have positive corporate tax liabilities each year, all but about the most profitable 3,000 qualify for reduced rates, although the lower-rate corporations earn only about 20 percent of total corporate profits. That provision not only provides a competitive advantage to some small and moderate-sized businesses, but other taxpayers benefit as well. For example, high-income individuals benefit because the provision allows them to shelter income as retained earnings in a small corporation. The tax law does not allow owners of personal service corporations, such as physicians, attorneys, and consultants, to incorporate themselves in order to gain the tax benefit. Other high-income individuals still use those opportunities for tax shelters, however. The Omnibus Budget Reconciliation Act of 1993 increased the incentive to use those shelters by raising the top statutory income tax rate for individuals to nearly 40 percent, while raising the top statutory rate for corporations to 35 percent. Additional unintended recipients of the tax benefit are large businesses with low profits. Furthermore, some of those large corporations may be able to control the timing of certain income and expenses in order to generate low taxable income--and the tax benefit--in certain years.

The reduced corporate rates do lessen the "double taxation" of corporate income. Owners of corporate businesses pay corporate tax on all of the earnings of the business and also pay individual tax on the part of their earnings that they receive as dividends. Owners of noncorporate businesses, however, pay tax at only the individual level on all earnings.

Lower corporate rates are not the only means, however, of reducing the double tax on the income of those businesses. As an alternative to incorporation, many businesses--especially small ones--could operate as sole proprietorships or partnerships and pay tax only under the individual income tax. In addition, many small businesses could continue to enjoy the advantages of incorporation by operating as S corporations, which must have 35 or fewer owners and satisfy other requirements. Shareholders in S corporations also pay only under the individual income tax.

REV-04 ELIMINATE OR LIMIT DEDUCTIONS FOR MORTGAGE INTEREST

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Eliminate Mortgage Interest Deductions	41.1	62.2	66.0	69.9	74.1	313.3
Reduce Maximum Mortgage Principal Eligible for Interest Deductions to $300,000	3.8	6.5	7.2	8.1	9.2	34.8
Limit Deductions to $12,000 per Return (Single) or $20,000 (Joint)	6.1	9.9	10.7	12.1	13.6	52.4
Limit Deductions for Second Homes	0.4	0.7	0.7	0.7	0.7	3.2

SOURCE: Joint Committee on Taxation.

A home is both the largest consumer purchase and the main investment for most Americans. The tax code has historically treated homes more favorably than other investments. Current law allows homeowners to deduct mortgage interest expenses, even though homes do not produce taxable income, and exempts most capital gains from home sales (see REV-21). Such preferential treatment may benefit neighborhoods because it encourages home ownership and home improvement. The amount of preference, however, is probably larger than needed to maintain a high rate of home ownership. For example, Canada, which grants preferential tax treatment to capital gains from home sales but does not allow deductions for mortgage interest, has achieved about the same rate of home ownership as the United States.

The tax advantages for owner-occupied housing encourage people to invest in homes instead of taxable business investments. That shift may contribute to a relatively low rate of investment in business assets in the United States compared with other developed countries that do not allow such large mortgage interest deductions. Currently, about one-third of net private investment goes into owner-occupied housing. Consequently, even a modest reduction in housing investment could raise investment significantly in other sectors.

Limiting mortgage interest deductions would substantially reduce the preferential treatment of owner-occupied homes, particularly for those homeowners who must borrow to purchase their homes. Under current law, taxpayers may deduct interest on up to $1 million of debt they have used to acquire and improve first and second homes and interest on up to $100,000 of other loans they have secured with a home, regardless of purpose (home-equity loans). No other type of consumer interest is deductible. Current law also limits the extent to which interest deductions for carrying assets other than first and second homes can exceed income from such assets.

The limits under current law on mortgage interest deductions result in a generous subsidy even for relatively expensive homes. Moreover, taxpayers with substantial home equity can circumvent the limits on consumer and investment interest deductions by using, for example, home-equity loans with deductible interest to finance automobiles and other consumer purchases or investment in assets other than homes. In contrast, renters and those with small amounts of home equity cannot use that method to deduct interest on the loans they use to finance auto and other purchases.

Eliminate Interest Deductions. Eliminating the deductibility of mortgage interest would raise the taxes of about 28 million homeowners by an average of about $2,100 in 1996 and increase tax revenues by about $313 billion over the 1996-2000 period. Housing as an investment would be made more nearly equal with other investment opportunities, thus reducing the incentive to overinvest in housing. Furthermore, eliminating the deduction would remove the opportunity for homeowners to circumvent provisions in the tax law that deny the deductibility of interest on other types of consumer expenditures. But eliminating the mortgage interest deduction would increase net mortgage payments sharply for current homeowners, potentially making it impossible for some to afford their homes. Eliminating the mortgage interest deduction would also cause the value of higher-priced homes to fall and would hurt homebuilders. Finally, the higher tax burden would fall most heavily on people who do not have sufficient wealth to purchase homes without mortgages but still itemize their deductions.

Reduce the Principal Eligible for Deduction. Lowering the limit on the amount of principal eligible for the mortgage interest deduction from $1 million to $300,000 would reduce deductions for about 1.2 million taxpayers with large mortgages and increase revenues by about $35 billion over the 1996-2000 period. That change would reduce the deduction only for owners of relatively expensive homes. It would not affect the vast majority of homeowners. The fraction affected would be greater in high-cost areas such as Honolulu and San Francisco. Because the proposal would not index the limits for inflation, the real value would gradually decline. Phasing down the limit gradually would cushion the effects on most current homeowners and the homebuilding industry.

Cap Interest Deductions. Capping the mortgage interest deduction would have effects similar to limiting the principal eligible for deduction. One difference is that fluctuating interest rates would affect deductions subject to the interest cap but would not affect deductions subject to the limit on mortgage principal. Capping the mortgage interest deduction at $12,000 per single return, $20,000 per joint return, and $10,000 per return for married couples who file separately would raise about $52 billion in revenues in 1996 through 2000. Those limits are much higher than the deductions most taxpayers claim. Of the 27 million taxpayers who claimed the mortgage interest deduction in 1992, about 1.5 million (5 percent) had deductions that exceeded those limits; the average deduction for home mortgage interest was about $7,300. At current mortgage interest rates, the proposed $20,000 cap would allow full interest deductions on new fixed-rate mortgages as large as about $225,000. Only 6 percent of new mortgages originated in 1994 exceeded that amount.

Like the other limits on interest deductions, the cap would be more restrictive in areas with higher housing costs. Further, in periods of high interest rates, the limits would affect recent homebuyers and those with adjustable-rate mortgages more than longer-term owners with fixed-rate mortgages.

Limit Interest Deductions for Second Homes. A final option is to limit deductibility only to interest on debt that taxpayers incur to acquire and improve a primary residence, plus $100,000 of other debt secured by that home. That approach would require interest deductions for second homes to qualify under the $100,000 limit on home-equity loans. The proposal would increase revenue by $3.2 billion in 1996 through 2000.

The deduction under current law provides special treatment for taxpayers who borrow to own second homes, relative to taxpayers who cannot deduct interest from consumer loans used to finance education, medical expenses, and other consumer purchases. Many second homes are vacation homes. Yet limiting the deduction of mortgage interest to a single home would retain the present preference for taxpayers with high mortgage interest on a costly primary home while denying it to other taxpayers with lower combined mortgage interest on two less costly homes.

REV-05 ELIMINATE OR LIMIT DEDUCTIONS OF STATE AND LOCAL TAXES

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Eliminate Deduction of State and Local Taxes	18.5	46.5	49.3	52.3	55.5	222.1
Limit Deductions to the Excess over 1 Percent of Adjusted Gross Income	2.1	7.0	7.4	7.8	8.2	32.5
Prohibit Deductibility of Taxes Above Ceiling of 8 Percent of Adjusted Gross Income	2.2	7.3	7.9	8.5	9.1	35.0

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers may deduct state and local income, real estate, and personal property taxes from their adjusted gross income (AGI). For taxpayers who itemize, the deductions provide a federal subsidy of state and local tax payments. That subsidy may cause itemizers to support higher levels of state and local services than they would otherwise; consequently, the deductions indirectly finance increased state and local government spending at the expense of other uses of federal revenues.

The Tax Reform Act of 1986 reduced the subsidy to state and local governments directly by repealing the deduction for state and local sales taxes, and indirectly by increasing the standard deduction and lowering marginal rates. The latter changes reduced both the number of itemizers and the value of the deductions. The Omnibus Budget Reconciliation Act of 1993 raised marginal tax rates for higher-income households and thus indirectly increased the value of the deductions.

As a way to assist state and local governments, deductibility of state and local taxes has several disadvantages. First, the deductions reduce federal tax liability only for itemizers. Second, because the value of an additional dollar of deductions increases with the marginal tax rate, the deductions are worth more to higher-bracket taxpayers. Third, deductibility favors wealthier communities. Communities with higher average income levels have more residents who itemize and are therefore more likely to spend more because of deductibility than lower-income communities. Fourth, deductibility may discourage states and localities from financing services with nondeductible user fees, thereby discouraging efficient pricing of some services.

An argument against restricting deductibility is that a taxpayer with a large state and local tax liability has less ability to pay federal taxes than one with equal total income and a smaller state and local tax bill. In some areas, a taxpayer who pays higher state and local taxes may receive more benefits from publicly provided services, such as recreational facilities. In that case, the taxes are more like other payments for goods and services (for example, private recreation) and should not be deductible. Alternatively, higher public expenditures resulting from deductibility benefit all members of a community, including lower-income nonitemizers who do not receive a direct tax saving.

Eliminating or limiting the value of the state and local deduction could raise significant revenues. Eliminating deductibility would raise more than $220 billion in 1996 through 2000. An alternative option would allow deductions only for state and local tax payments above a fixed percentage of AGI. A 1 percent floor on deductions would increase revenues in 1996 through 2000 by $32.5 billion. Another alternative would be to prohibit deductions above a fixed ceiling, which also might be a percentage of AGI. A ceiling set at 8 percent of AGI would increase revenues by a roughly similar amount--$35 billion in 1996 through 2000. A floor and a ceiling, however, would have very different effects on incentives for state and local spending. A floor would retain the incentive for increased spending, but a ceiling would reduce it.

REV-06 ELIMINATE OR LIMIT DEDUCTIONS FOR CHARITABLE GIVING

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Eliminate Deductions for Charitable Giving	1.8	17.7	18.6	19.3	20.2	77.6
Limit Deductions for Appreciated Property to Its Tax Basis	0.1	1.4	1.4	1.5	1.5	5.9
Limit Deductions to the Excess over 2 Percent of Adjusted Gross Income	0.9	8.6	9.1	9.5	10.0	38.1

SOURCE: Joint Committee on Taxation.

Under current law, taxpayers who itemize deductions can deduct the value of contributions they make to qualifying charitable organizations. The amount of deductions cannot exceed 50 percent of adjusted gross income in any year. In 1993, 30 million taxpayers claimed $67 billion of deductions for charitable contributions, reducing federal revenues by about $17 billion.

In addition to cash donations, taxpayers can deduct the fair market value of a contribution of appreciated property that they have held for more than 12 months, regardless of how much they paid for the property.

Eliminating the deductibility of charitable contributions would increase tax revenues by $1.8 billion in 1996 and by about $78 billion over the 1996-2000 period. In 1997, it would increase tax payments of about 30 million taxpayers by an average of nearly $600 per return.

The deduction provides significant government support for charitable activities. But one criticism of the deduction is that the electorate as a whole, and not individual donors, should make decisions about which activities deserve taxpayer support. Another criticism is that the deduction provides unequal federal matching rates for contributions by different taxpayers. The government subsidy rates can exceed 40 percent of contributions for the highest-income taxpayers, but are only 15 percent for taxpayers in the lowest tax bracket and zero for people who do not itemize deductions.

Nonetheless, the decisions of individuals about donations may be the best measure of which activities should receive government support and yield substantial contributions. Without deductibility, contributions might drop precipitously.

Limiting the deduction of appreciated property to a taxpayer's cost of an asset under the regular income tax would increase revenues by about $0.1 billion in 1996 and by nearly $6 billion over five years. The existing provision allows taxpayers to deduct the entire value of assets they contributed even though they paid no tax on the gain from appreciation. That outcome provides preferential treatment to one kind of donation relative to other kinds and expands the preferential treatment of capital gains (see REV-22). However, the provision encourages people to donate appreciated assets to eligible activities rather than passing them on to their heirs at death, when any gains also escape income tax.

Another way to limit the charitable deduction, while retaining an incentive for giving, is to allow taxpayers to deduct only those contributions in excess of 2 percent of adjusted gross income. That alternative would retain an incentive for increased giving by people who give a large share of their income but would remove the incentive for smaller contributors. It would completely disqualify the charitable deductions of about 17 million taxpayers in 1996 and reduce allowed deductions for an additional 13 million, increasing revenues by about $0.9 billion in 1996 and by $38 billion over the 1996-2000 period. Such a change would eliminate the tax incentive for about 60 percent of the taxpayers who currently make and deduct charitable contributions. In addition, it would encourage taxpayers who planned to make contributions over several years to lump them together in one tax year to qualify for a deduction with the 2 percent floor.

REV-07 LIMIT THE TAX BENEFIT OF ITEMIZED DEDUCTIONS TO 15 PERCENT

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	27.2	60.8	64.4	68.2	72.1	292.7

SOURCE: Joint Committee on Taxation.

Current law allows taxpayers to reduce taxable income by the amount of itemized deductions in excess of the standard deduction. Taxpayers who itemize may deduct state and local income and property taxes, home mortgage interest payments, contributions to charity, employee business expenses, moving expenses, casualty and theft losses, and medical and dental expenses. Current law limits some itemized deductions to the amount in excess of a percentage of adjusted gross income and reduces all itemized deductions for high-income taxpayers.

The tax benefit of itemized deductions increases with a taxpayer's marginal tax bracket. For example, $10,000 in itemized deductions would reduce taxes by $1,500 for a taxpayer in the 15 percent tax bracket, $2,800 for a taxpayer in the 28 percent bracket, and $3,960 for a taxpayer in the 39.6 percent bracket. Most taxpayers do not itemize deductions. Among the one in four taxpayers who do itemize, however, about half are in tax brackets above 15 percent. This option would limit the tax benefit of itemized deductions to 15 percent for those higher-bracket taxpayers. The limit would increase revenues by almost $300 billion over five years.

Limiting the tax benefit of itemized deductions would make the income tax more progressive by raising average tax rates for most middle- and upper-income taxpayers. The limit might also improve economic efficiency because it would reduce tax subsidies that distort the after-tax prices of goods, such as owner-occupied housing.

The itemized deductions for health expenses, casualty losses, and employee business expenses, however, are not subsidies of voluntary activities, but are instead allowances for costs that reduce the ability to pay income tax. Under this option, some taxpayers would pay tax on receipts they use to defray such costs because they would pay tax on their gross income at rates above 15 percent, but could deduct only 15 percent of the cost of earning income. Thus, an individual with unusually high medical bills, for example, would pay more tax than another individual with the same ability to pay but who had low medical bills.

Like other limits on itemized deductions, this option would create incentives for taxpayers to avoid the limit by converting itemized deductions into reductions in income. For example, taxpayers might draw down assets to repay mortgages, reducing both income and mortgage payments, or donate time or services rather than cash to charities. The option would also make calculating taxes more complex for itemizers.

REV-08 PHASE OUT THE DEPENDENT-CARE CREDIT

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
Set the Phaseout Starting at:						
$30,000	0.9	1.5	1.5	1.6	1.7	7.2
$50,000	0.5	0.9	0.9	1.0	1.1	4.4
$65,000	0.3	0.5	0.6	0.6	0.7	2.7

SOURCE: Joint Committee on Taxation.

Taxpayers who incur employment-related expenses for the care of children and certain other dependents may claim an income tax credit. The credit per dollar of qualifying expenses declines from 30 percent for taxpayers whose adjusted gross income (AGI) is $10,000 or less to 20 percent for taxpayers whose AGI is above $28,000. The tax law limits creditable expenses to $2,400 for one child and $4,800 for two or more. Creditable expenses cannot exceed the earnings of the taxpayer or, in the case of a couple, the earnings of the spouse with lower earnings. In 1992, taxpayers claimed about $2.5 billion in credits on 6 million tax returns.

About 40 percent of the credit benefits families with incomes of $50,000 or more. Retaining the credit only for lower-income families would reduce its revenue cost. One way to do that would be to reduce the percentage of credit as income rises. For example, reducing the credit percentage by 1 percentage point for each $1,500 of AGI more than $30,000 would raise about $7.2 billion from 1996 through 2000. This option would reduce the credit for about 38 percent of currently eligible families and eliminate it for another 30 percent of those families (ones with AGI over $58,500). Alternatively, phasing out the credit between $50,000 and $78,500 would raise about $4.4 billion in the same period. This option would reduce the credit for about 25 percent of eligible families and eliminate it for another 14 percent. Finally, phasing out the credit between $65,000 and $93,500 would raise $2.7 billion in the same period, reducing the credit for about 17 percent of eligible families and eliminating it for another 8 percent.

The credit provides a work subsidy for families with children. Phasing out the credit for higher-income families targets that subsidy toward families with greater economic need, but may discourage parents in families with a reduced credit from working outside the home.

If the credit was phased out, higher-income employees could seek other tax benefits for dependent care by asking their employers to provide subsidized day care. Current law allows workers to exclude from taxable income up to $5,000 of annual earnings used to pay for dependent care through employer-based programs. To preclude taxpayers from using this alternative, the Congress could limit the use of the fringe benefit.

REV-09 IMPOSE AN EXCISE TAX ON NONRETIREMENT FRINGE BENEFITS

	Annual Added Revenues (Billions of dollars)					Cumulative Five-Year Addition
	1996	1997	1998	1999	2000	
Addition to Current-Law Revenues	4.3	6.5	7.0	7.5	8.0	33.3

SOURCE: Joint Committee on Taxation.

NOTE: Estimates are net of reduced income and payroll tax revenues.

Unlike employee compensation paid in cash, many fringe benefits are exempt from income and payroll taxes. The exemption of employer-paid health and life insurance premiums from tax will cost about $57 billion in income taxes and $38 billion in payroll taxes in 1996. In addition, the law explicitly excludes from gross income employer-paid dependent care and miscellaneous benefits such as employee discounts, parking valued below a specified limit, and athletic facilities.

Those exclusions effectively subsidize the price of the fringe benefits, causing people to consume more of such benefits than they would if they had to pay the full price. As a result, resources may be allocated inefficiently. For example, excluding employer-provided parking facilities from taxation has encouraged people to drive to work rather than commuting by other means and encouraged employers to build parking facilities on land that might have more productive uses. (The parking subsidy has been partly offset in recent years by another fringe benefit: the exclusion for car pool subsidies and transit passes.) Excluding employer-provided health insurance has contributed to the large and growing demand for health care services. (See REV-10.)

Such exclusions are inequitable because an individual who earns compensation in cash pays more tax than one with the same total income, part of which is paid in the form of fringe benefits. That inequity is exacerbated to the extent that the higher demand for the fringe benefit by employees drives up the price for people who have to purchase it with after-tax dollars. Moreover, because the income tax is progressive (higher-income people pay higher tax rates), the tax exclusion is worth more to people with higher income. Higher-income people also receive more fringe benefits than lower-income people. As a result, the tax savings from the exclusion are very unevenly distributed among income groups.

Making all fringe benefits taxable, however, would present problems in valuing benefits and in assigning their value to individual employees. Appraisal is simple when the employer purchases goods or services and provides them to employees, but it is more difficult to determine the value of a facility, such as a gym, that employers provide. Further difficulties arise if the employer must allocate to individual employees the total value of the fringe benefits they provide. For example, in cases in which the employer provides a service, such as employee discounts, it might be unfair to assign the same taxable value to all employees regardless of their level of use. Conversely, it would be administratively complex to assign values that depended on each worker's use. Further, the costs of collecting taxes on small fringe benefits (such as employee discounts) might exceed the revenue collected.

An alternative to including employer-provided benefits as income to recipients would be to impose on employers an excise tax on the value of the benefits that they provide. Those benefits would include the employer's share of health insurance (see REV-10); premiums to fund the first $50,000 of life insurance, the part that is excluded from income (see REV-11); dependent care; athletic facilities; employee discounts; and parking with a value up to the amount above which it is currently taxed. (Under current law, employees must include in taxable income in 1995 the market value in excess of $160 per month, indexed for inflation beyond 1995, of any parking provided free of charge by an employer.) A 3 percent tax, for example, would raise about $33 billion from 1996 through 2000. The bulk of those revenues would come from taxing employer-paid health insurance.

Under this option, employers would need to know only their total fringe benefit costs; they would not have to place a value on the benefits paid to each employee. Because the 3 percent excise tax rate would be much lower than the tax rate on wages, this option would maintain most of the incentive for employers to provide fringe benefits instead of taxable wages.

A flat-rate excise tax on employers would be relatively more favorable to higher-income employees than including fringe benefits in employees' taxable income. Under an excise tax, the rate would not rise with the income of employees, as it would if the benefits were subject to the income tax.

REV-10 TAX EMPLOYER-PAID HEALTH INSURANCE

Addition to Current-Law Revenues	Annual Added Revenues (Billions of dollars) 1996	1997	1998	1999	2000	Cumulative Five-Year Addition
	Tax Some Employer-Paid Health Insurance					
Income Tax	7.0	10.3	11.8	13.5	15.4	58.0
Payroll Tax	4.9	7.1	8.1	9.3	10.6	40.0
Total	11.9	17.4	19.9	22.8	26.0	98.0
	Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit					
Income Tax	24.9	-0.4	-0.2	0.1	0.6	25.0
Payroll Tax	26.1	36.7	39.4	42.1	45.1	189.4
Total	51.0	36.3	39.2	42.2	45.7	214.4

SOURCE: Joint Committee on Taxation.

Employees do not pay taxes on income they receive in the form of employer-paid health insurance. In addition, health insurance premiums and health care costs paid through a cafeteria plan are generally excludable from income and payroll taxes. Those exclusions will reduce income tax revenues and payroll tax revenues by a total of about $92 billion in 1996. Limiting or modifying the tax exclusion represents an incremental approach toward some of the objectives for health policy stated by the Administration and Congressional reformers that could also reduce the deficit. Some comprehensive health policy proposals introduced in the previous Congress included limits on the tax exclusion.

Tax Some Employer-Paid Health Insurance. One way to limit the exclusion would be to treat as taxable income for employees any employer contributions for health insurance plus health care costs paid through cafeteria plans that exceed $360 a month for family coverage and $170 a month for individual coverage. Those amounts are estimated averages for 1996, which would be indexed to reflect future increases in the general level of prices. The option would raise income tax revenues by $58 billion and payroll tax revenues by $40 billion over the 1996-2000 period. Including employer-paid health care coverage in the Social Security wage base, however, would lead to increased outlays on Social Security benefits that could offset most of the added payroll tax revenues from this option over the long run.

An advantage of this approach is that it would eliminate the tax incentive to purchase additional coverage beyond the ceiling. Without such coverage, there would be stronger incentives to economize in the medical marketplace, thereby reducing upward pressure on medical care prices and the provision of unnecessary or marginal services. Because the option indexes the ceiling amounts to the overall inflation rate, while health care costs have been rising faster than inflation, it could constrain health care costs even more over time. The Congress has already limited the exclusion for employer-paid group term life insurance in a similar way.

One disadvantage of limiting the tax exemption of employer-paid medical insurance premiums is the difficulty of determining when extensive coverage becomes excessive. Also, a given premium purchases different levels of coverage depending on such factors as geographic location and the characteristics of the firm's workforce. As a result, a uniform ceiling would have uneven effects. Finally, if health insurance costs continued to rise faster than the general level of prices, indexing to reflect the general level of prices would gradually reduce subsidies for employer-paid health insurance. The result of all of those factors could be to increase the number of workers without health insurance.

Tax All Employer-Paid Health Insurance, but Allow Individuals a Credit for Premiums They or Their Employers Pay up to a Limit. Another option would treat all employer-paid health insurance premiums as taxable income and disallow payments for health care costs through cafeteria plans, but offer a refundable individual income tax credit of 20 percent for health insurance premiums up to the amounts described above for family and individual coverage. The credits would be available to taxpayers whether or not their employers paid for or sponsored the coverage. The option would increase income tax revenues by $25 billion over the 1996-2000 period. That amount would be the net result of about $250 billion in revenues if there was no credit, less about $225 billion in new income tax credits. The net income tax gain occurs largely in the first year because many taxpayers would not adjust their withholding to take account of the credit. Payroll tax revenues would rise substantially, however--by about $190 billion over the same period. But as under the first option, increases in Social Security outlays could offset most of the added payroll tax revenues in the long run.

In addition to eliminating the tax incentive for excessive health insurance, as under the first alternative, an added advantage of this option is that the subsidy would be available to all taxpayers who purchased health insurance, without regard to their employment status. Moreover, the subsidy per dollar of eligible health insurance premiums would no longer be relatively higher for taxpayers with higher marginal tax rates (and higher incomes). Limiting the amount of insurance eligible for credits to a fixed level, however, creates all of the same problems as in the first option. Moreover, by extending the subsidy to individual purchases of insurance, the option might induce relatively healthy employees to buy insurance outside the work place. Consequently, insurance would become more expensive for the remaining employees, especially at small firms, and that rise in cost could cause more firms to terminate coverage.