Over the first five calendar years, the increases and decreases in aggregate depreciation would be almost exactly offsetting. However, because the revenue effect of the change in 1990 depreciation would be divided between fiscal years 1990 and 1991, the revenue effect over the first five fiscal years of the depreciation proposal alone would be negative. After the first five years depreciation increases rapidly, compared with current law, for three years, and then stabilizes at 0.6 percent (later 0.5 percent) of GNP.

If CCRS depreciation were compared with ACRS without the ITC basis adjustment[16] (so that the revenue loss from removing the basis adjustment could be subtracted from the revenue gain from repealing the ITC), the proposal would show a smaller increase in depreciation. The pattern of changes, however, would still be the same.

Table 5 shows the proportions of the original cost of new equipment purchased in one year which would be claimed as annual depreciation deductions under both ACRS and CCRS[17]. Investment in producers' durable equipment is about two-thirds of business fixed investment, and more than 70 percent of corporations' fixed investment. Because of its volume, and because it is written off faster than structures under any tax system, depreciation of equipment dominates the pattern of depreciation changes in the first years following any rule change. Therefore, Table 5 illustrates the major reason CCRS would provide more depreciation deductions than ACRS in most years. As shown in Table 5, CCRS would provide more generous deductions than ACRS for three-year equipment in every year the equipment was depreciated except the third. For a weighted average of new equipment in the five-year ACRS class, CCRS would provide more generous deductions in the first and second year, and, with inflation averaging 3 percent or higher, CCRS deductions totaling more than 25 percent of the original cost would be taken over years in 6 through 11, after tax depreciation would have been completed under ACRS.

Public utilities would claim more depreciation, and at a faster rate than under ACRS, because the bulk of public utility property would move from the 15-year ACRS class to being depreciated over ten years with indexing. At a 4 percent inflation rate, the depreciation factors for structures (other than public utility property) would be lower than ACRS

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16 Under current law, the depreciable basis of equipment is reduced by 50 percent of the ITC for which it is eligible.

17 Actual depreciation deductions in any year are the sum of the first year's depreciation factors (as shown in Table 5) applied to the current year's investment, the second year's depreciation factors applied to last year's investment, and so forth. Therefore, the reduction in the third year factor for three-year equipment and in the third through fifth year factors for five-year equipment reduce total depreciation on equipment only in years when their effect is not outweighed by increased depreciation factors applied to older and newer equipment.

TABLE 5. ANNUAL DEPRECIATION FACTORS FOR EQUIPMENT UNDER ACRS AND CCRS (As a share of original cost)

	Year					
	1	2	3	4	5	Years 6-11 (Sum)
ACRS						
3-year	.25	.38	.37			
After ITC basis adjustment	.243	.369	.359			
5-year	.15	.22	.21	.21	.21	
After ITC basis adjustment	.143	.209	.200	.200	.200	
CCRS Before Indexing						
Class 1	.275	.399	.179	.098	.048	
Class 2 (25%)	.220	.343	.192	.108	.092	.045
Class 3 (19%)	.165	.276	.185	.124	.100	.151
Class 4 (51%)	.110	.196	.153	.119	.122	.300
Class 5 (5%)	.085	.156	.129	.107	.089	.434
Weighted Average						
Classes 2-5	.147	.246	.167	.116	.109	.215

Continued

TABLE 5. (Continued)

	Year					
	1	2	3	4	5	Years 6-11 (Sum)
CCRS After Indexing						
4% Inflation						
Class 1	.275	.415	.194	.111	.057	
Classes 2-5	.147	.256	.181	.131	.127	.270
3% Inflation						
Class 1	.275	.411	.190	.107	.055	
Classes 2-5	.147	.253	.178	.127	.122	.255
5% Inflation						
Class 1	.275	.419	.198	.114	.059	
Classes 2-5	.147	.258	.185	.135	.132	.286
DIFFERENCE (CCRS-ACRS)						
4% Inflation						
Class 1	.033	.042	-.165	.111	.057	
Classes 2-5	.004	.047	-.018	-.069	-.072	.270
3% Inflation						
Class 1	.033	.042	-.169	.107	.055	
Classes 2-5	.004	.044	-.022	-.072	-.077	.255
5% Inflation						
Class 1	.033	.050	-.161	.114	.059	
Classes 2-5	.004	.049	-.015	-.065	-.067	.286

TABLE 6. AGGREGATE REVENUE EFFECTS OF PROPOSED CHANGES IN CORPORATE TAX RATES, REPEAL OF THE ITC, CHANGES IN THE TREATMENT OF DEPRECIATION, AND A PARTIAL DIVIDENDS-PAID DEDUCTION (Unified budget, changes from current law)

Fiscal Year	Billions of Dollars	Percent of GNP
1986	4.1	0.1
1987	-4.1	-0.1
1988	-11.1	-0.2
1989	-4.9	-0.1
1990	1.0	0.0
1991	0.6	0.0
1992	-6.1	-0.1
1993	-11.2	-0.2
1994	-14.2	-0.2
1995	-16.0	-0.2
1996	-17.5	-0.2
1997	-18.2	-0.2
1998	-18.6	-0.2
1999	-18.9	-0.2
2000	-19.3	-0.2

SOURCE: Congressional Budget Office.

for the first nine years, but over the life of the property total depreciation deductions would equal 181 percent of the original cost, or 81 percent more than under ACRS. The full revenue effect of indexing depreciation on structures would not be felt until well beyond the year 2000.

The change in depreciation for noncorporate business, which is not shown in Table 4, follows a similar pattern. However, because noncorporate business investment is much more heavily weighted toward structures than corporate investment (more than 30 percent instead of less than 20 percent) and does not include significant amounts of public utility property, the change from ACRS to CCRS would reduce noncorporate depreciation from 1988 through 1991. Because noncorporate investment is smaller than corporate investment, the increase in depreciation after 1991 would amount to less than 0.1 percent of GNP through 2000. Although later, when the full impact of indexing depreciation of real property was felt, the net increase in depreciation and the associated revenue loss would be larger.

Fifteen-Year Revenue Profile of the General Corporate Provisions of the Administration's Proposal

Table 6 shows CBO estimates of the revenue effects of the general corporate provisions in the Administration's proposal, compared with current law. These general provisions include the change from ACRS to CCRS depreciation, the reduction in the maximum statutory rate on corporate profits from 46 percent to 33 percent, the repeal of the Investment Tax Credit (ITC), and the provision of a deduction for 10 percent of dividends paid. CCRS and the repeal of the ITC occurs on January 1, 1986, the rate reduction takes place on July 1, 1986, and the dividend deduction on January 1, 1987.

Over the first five years the net effect of these provisions would be a $15 billion reduction in corporate taxes (about 0.1 percent of GNP). These provisions, however, would be offset by the revenue gains from corporate base-broadening and the windfall recapture tax. After 1991, the general provisions of the proposal included here would provide a reduction in corporate taxes equal to about 0.2 percent of GNP or roughly 1 percent of total revenues.[18] The corporate tax is expected to average about 2.3 percent of GNP by 1990 (assuming that corporate profits remain above their historical average of 8 percent of GNP). Thus, 0.2 percent of GNP would mean a reduction of almost 9 percent in corporate tax revenues.

Comparison with Treasury Department Revenue Estimates

Revenue estimates for individual portions of tax proposals depend crucially on the order in which the estimates are made. For instance, when a

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[18] The Administration has defined revenue neutrality as within 1.5 percent of revenues under current law.

proposal contains both base-broadening provisions and reductions in tax rates, the revenue gain from each base-broadening provision will be larger if it is estimated at the current law rate (and the revenue loss from the rate reduction will look larger because it will be estimated from a broader base.) The Treasury's estimates for the Administration's tax reform proposal show the revenue effects of the base-broadening provisions, as well as the depreciation change, as though the statutory rate were 46 percent. The revenue effect of the rate reduction is the result of applying the lower rate to the new base, which is considerably broader than current law. The revenue effect of the dividends-paid deduction is then estimated at the proposed 33 percent maximum rate, and with the level of dividend payments that would be expected to result from the rate reduction.

In Table 7, the revenue estimate shown in Table 6 was decomposed into each of the four general provisions, the stacking order used by the Treasury was imposed (there is no stacking order when all estimates are made simultaneously), and Treasury estimates of the base-broadening and other provisions (scaled down where appropriate) were combined with the rate reduction. These calculations allow a direct comparison with the Treasury's estimates. Differences shown for the total proposal obviously are due only to the four provisions estimated by CBO. Within those four provisions, portions of the differences in the revenue estimates can be attributed to offsetting definitional differences, such as attributing the effect of losing the ITC basis adjustment upon repeal of the ITC to the revenue gain from repeal instead of including it in the revenue change from depreciation.

As previously mentioned, revenue estimates are also sensitive to economic assumptions. In Table 7 the Treasury estimates are based on the latest Administration economic assumptions. The CBO estimates are based on the CBO baseline economic projections from February 1985.

Differences in the estimated revenue effect of ITC repeal primarily result from different assumptions about the rate at which ITC carryovers (which would not be included in the repeal) would be taken once repeal dried up the supply of new credits.

Estimates of the revenue effect of the depreciation changes differ because of different assumptions about the mix of investment, and different levels of total investment in the economic forecasts.

The estimated effect of a rate cut, even in a static estimate, depends on the effects of other portions of the proposal on the tax base, whether the rate cut is stacked before or after changes in the base. For example, in a proposal that combines a depreciation change with a rate reduction, significant differences in the estimated change in depreciation would have significant effects on the tax base, and therefore on the revenue effect of the rate reduction. The $30.6 billion five-year difference in the estimated revenue effect of the depreciation proposal implies a taxable income difference of $66.5 billion. Adding that amount to the CBO baseline projection for profits would have increased CBO's estimate of the revenue loss from the rate reduction by more than $8 billion.

TABLE 7. COMPARISON OF CBO AND TREASURY FIVE-YEAR ESTIMATES (Unified budget, billions of dollars)

	1986	1987	1988	1989	1990	Total
ITC Repeal						
Treasury Estimate	14.0	25.6	29.4	33.3	37.4	139.7
CBO Estimate	11.0	24.0	28.8	33.8	37.9	135.5
Difference	-3.0	-1.6	-0.6	0.5	0.5	-4.2
Depreciation Change, Valued Before Rate Reduction						
Treasury Estimate	0.3	-0.7	2.3	8.7	15.4	26.0
CBO Estimate	-0.8	-4.3	-4.8	-0.2	5.5	-4.6
Difference	-1.1	-3.6	-7.1	-8.9	-9.9	-30.6
Rate Reduction and Base Broadening						
Treasury Estimate	4.6	4.6	-1.2	-10.9	-19.6	-22.5
CBO Estimate	6.3	6.7	0.8	-10.3	-20.5	-16.9
Difference	1.7	2.1	2.0	0.6	-0.9	5.6
Dividend Deduction, Valued at 33 Percent						
Treasury Estimate	0.0	-3.4	-6.2	-7.2	-8.0	-24.8
CBO Estimate	0.0	-2.4	-5.0	-5.4	-5.8	-18.6
Difference	0.0	1.0	1.2	1.8	2.2	6.2
Total Proposal						
Treasury Estimate	18.9	26.1	24.3	23.9	25.2	118.4
CBO Estimate	16.6	24.0	19.8	18.0	17.1	95.4
Total Difference	-2.3	-2.1	-4.5	-5.9	-8.1	-23.0

SOURCE: Treasury estimates are based on the latest Administration economic assumptions and the CBO estimates are based on the CBO baseline economic projections from February 1985.

The estimated revenue loss from the dividends-paid deduction is determined by the forecast level of profits and the share of profits assumed to be paid out in dividends. The April 1985 Administration forecast on which the Treasury's estimates were based has very similar book profits to the CBO baseline. Thus, differences are more likely to be the result of dividend payout assumptions. CBO's estimate assumes that the allocation of after-tax profits to dividends and retained earnings is about half-way between keeping the ratio of dividends to economic income unchanged, and keeping the ratio of retained earnings to economic income unchanged.

ADDITIONAL PROVISIONS THAT MAY HAVE IMPORTANT LONG-RUN REVENUE IMPLICATIONS

Several major tax reform provisions not estimated here have long-run revenue effects (relative to GNP) that may be significantly different from their effect in 1990 (the last year for which Treasury reports revenue estimates for the President's tax reform plan). Brief descriptions of the provisions and the associated long-run potential revenue effects are presented below:

1. Match Income and Expense From Multiperiod Production (+$14.1 billion in 1990). Under current law, taxpayers are allowed to deduct certain costs prior to the realization of income from a particular investment. For example, timber producers are allowed to deduct certain growing expenses or carrying costs prior to the realization of income from timber production. Defense contractors are allowed to deduct overhead and interest costs prior to the realization of income from long-term government contracts. The President's plan would require businesses to match their expenses with the income generated by those expenses so that the timing of tax liability is more accurately matched to the receipt of income. In effect, this provision requires many firms to postpone the recognition of expenses for tax purposes until the associated income is also recognized.

This type of tax provision results in some acceleration of tax payments because the denial of certain deductions today means that future deductions will be correspondingly higher. For example, a deduction that is denied in 1990 might be subsequently realized in 1993, thereby raising 1990 revenues and lowering revenues in 1993, but other deductions would be denied in 1993, resulting in higher revenues in that year. The net result of these two offsetting effects in future years depends on the rate of growth of new contracts, the amount of deductions deferred, and the length of time of the deferral. Because these provisions basically apply to new contracts, revenue growth should be rapid in the first few years as the stock of affected agreements increases rapidly. As soon as most contracts are covered by the new provisions, the revenue gain should decline (relative to GNP) because of the offsetting deferrals. On balance, the provisions should provide a permanent increase in revenues as long as the nominal growth in affected contracts continues.

2. Reduce Capital Gains Exclusion to 50 Percent (+$5.4 billion in 1990). This provision raises two long-run revenue issues. The first is that the provision includes a rule that allows taxpayers the option of taking the exclusion or indexing their cost basis in computing gains subject to taxation after 1991. Thus, after 1991, this election should tend to reduce substantially effective tax rates on gains with a large inflationary component, thereby lowering revenues from this provision.[19]

A second issue has to do with the inclusion of induced realizations in the revenue estimates. To the extent that induced realizations reflect acceleration of gains that would ultimately have been realized, taxes on capital gains in the future would be reduced. Thus, the long-run revenue effect from this provision may be lower than its initial effect (relative to GNP) to the extent that future realizations are lower than they would be otherwise.

3. Eliminate Private-Purpose Tax Exempt Bonds (+$4.5 billion in 1990). The annual revenue gain from this provision depends on the change in the stock of outstanding tax-exempt bonds and the interest rate. The provision, however, only applies to bonds issued after 1985. Therefore, revenue growth should be rapid in its first few years as the stock of bonds issued after 1985 would grow quite rapidly. As the growth in post-1985 total private purpose bonds would eventually slow down, revenue growth would also slacken. The long-run revenue gain relative to GNP from this provision is likely to be higher than indicated by the 1990 revenue estimate because the stock of new tax-exempt bonds in the baseline would presumably still be growing at a fairly rapid rate (relative to GNP) at that time.

4. Tax Some Health Insurance Benefits (+$4.0 billion in 1990). To the extent that the population covered by health insurance grows in future years, the amount gained by this provision should also tend to grow. This effect would be offset by the fact that the inclusion amounts ($10 per month for individual coverage and $25 per month for family coverage) are not indexed for inflation. The real taxation of these benefits will decline over time as long as inflation remains positive. Therefore, the revenue from this provision may not keep pace with GNP growth in the longer-run.

5. Repeal Three-Year Basis Recovery Rule For Contributory Retirement Plans (+$2.8 billion in 1990). Under current law, distributions from contributory retirement plans are partially taxed. The portion attributable to employer contributions and pension plan earnings is taxable, while the portion attributable to employee contributions is not taxed because the contributions were made from after-tax income. When the amount to be distributed during the first three years exceeds

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[19] However, indexing would only cover inflation after January 1, 1991. Thus, under the moderate inflation rates generally assumed for long-term forecasts, this provision would have no effect for several years.

the total employee contribution, taxpayers are allowed to recover these after-tax contributions first (until they have recovered the full amount of their contributions); subsequent benefit distributions are counted as taxable income. The President's proposal would accelerate the recognition of some pension benefits for income tax purposes by eliminating the three-year recovery rule and applying an annual exclusion ratio to all benefit payments that reflects the expected ratio of return of (after-tax) contributions to total payments over the annuitant's lifetime. The effect of this provision is to increase taxable benefits in earlier years and reduce them in future years. This provision would apply to annuities that begin to make payments after January 1, 1986.

Because this provision applies only to annuities that go into pay status after 1985, the revenue from this provision could grow to well above its 1990 ratio to GNP. This growth in revenue would happen as more and more contributions are subject to the new rules. On the other hand, there is a future offsetting effect because, for any retiree, the proportion of benefits that will be taxable in the later years of his or her annuity will decline relative to current law. The net effect on future revenues from this provision is uncertain.

6. Modify Taxation of Cash and Deferred Arrangements (CODAs) (+$2.8 billion in 1990). This proposal would limit to $8,000 the amount that an individual could contribute to a CODA plan (otherwise known as a 401(k) plan). This limit would be coordinated with the limit on the amount that an individual can contribute to an individual retirement account (IRA). This provision substantially reduces the tax free contribution limits for highly paid individuals.[20]

Because these plans have been growing quite rapidly in recent years, the revenue increase from this proposal is likely to grow faster than GNP for a number of years. Moreover, because the contribution limits are not indexed for inflation, they will become a more stringent restriction in future years as prices continue to rise. On the other hand, there will be an offsetting future revenue effect because tax free contributions are taxable when distributed. Limiting tax free contributions will eventually result in lower taxable distributions, which will offset part of the revenue gain in future years.[21]

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[20] The President's proposal contains complex provisions to broaden CODA participation at lower wage levels in enterprises that maintain a CODA. These provisions may contribute to a decline in CODA growth because they make them less attractive to higher-paid management officials.

[21] For example, each dollar deposited in a taxable savings account instead of a CODA (because of the new limit) would raise tax revenues in the year deposited by 30 cents for a taxpayer in the 30 percent bracket. If the nominal interest rate were equal to 10 percent, taxes on interest in the four succeeding years would raise revenues by another 12 cents for a

7. Limit Property and Casualty Loss Reserves. (+$2.3 billion in 1990). Property and casualty insurance companies are currently allowed to deduct amounts set aside (on their books) to cover expected future losses. These amounts are based on their experience, but are not discounted for the fact that the losses will be paid off in the future, thereby allowing the company the use of the funds in the interim. This proposal would effectively require companies to limit their deductions to the present value of expected future losses. This requires companies to take account of the interest earned on their reserves when computing the amounts they need to set aside to cover future losses. The result is a reduction in the amounts deducted by companies to cover future losses and a corresponding increase in revenues.

This proposal would apply to policies issued after 1985 and should therefore grow as the number and value of new policies grows over time.

8. Repeal Most of Percentage Depletion (+$1.7 billion in 1990). The transition provisions for this change would be completed by 1990. The 1990 revenue effect from this provision could overstate its long-run growth (relative to GNP) because some of the reduction in percentage depletion deductions would be offset by future deductions for indexed cost depletion. Producers not allowed percentage depletion under this proposal would instead be allowed to take indexed cost depletion deductions to recover their investments in extractive operations.

9. Limit Individual Interest Deductions (+$1.5 billion in 1990). The President's proposal places a ceiling ($5,000) on individual interest deductions in excess of investment income, excluding deductions for mortgages on primary residences. This limit is not indexed for inflation. Therefore, the revenue growth from this provision may grow faster than the rate of GNP growth.

10. Limit Bad-Debt Deductions of Non-Depository and Depository Institutions (+$2.5 billion in 1990). The President's proposal would repeal the special provisions that allow taxpayers to deduct bad-debt reserves based on expected loan losses, instead of deducting the actual losses when they are realized, and that allow commercial banks and thrift institutions to deduct bad-debt reserves that are larger than their expected loan losses. Transition rules would gradually bring existing reserves into taxable income, in order to avoid double

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five year revenue gain of 42 cents. Suppose further that the CODA deposit would have been withdrawn after 15 years. Under those assumptions, there would be additional taxes on interest accumulated in years 6 to 15 under the proposal, followed by an offsetting loss of $1.25 that would have been collected on withdrawal of the tax-free contribution from the CODA in the fifteenth year. The present value over the entire period of the revenue gain per dollar invested in the first year would, in this example, be 23 cents, compared with the 42 cents gain over the first five years.

deductions for loans that become partially or completely worthless after the effective date of the proposal.

For most taxpayers, the switch from bad-debt reserves to deduction of actual losses only delays deductions, without changing the amounts that will eventually be deducted. The revenue effect from this proposal involves an immediate forward shifting of revenues and some long-run growth depending on the rate of growth in bad-debt deductions over time. In contrast, the bad-debt reserve provisions for depository institutions have provided a permanent tax reduction, part of which is subject to the additional tax on corporate tax preferences. Repeal of these provisions will permanently increase taxes on commercial banks and thrift institutions, although the revenue gain as a share of GNP will depend on the future health of commercial banks and thrift institutions.

11. Increased Spousal IRA's (-$1.1 billion in 1990). The President's plan proposes to raise the limit on tax deductible contributions to IRA's for couples with a nonworking spouse from $2,250 to $4,000. The annual revenue loss is likely to decrease slowly as a percentage of GNP in the years immediately after the five-year projection period because the ceiling on contributions is not indexed and will decrease substantially in later years when withdrawals from spousal IRAs begin since the withdrawals will be fully taxable.

12. Extension of the Research and Experimentation Tax Credit (-$1.9 billion in 1990). The President's plan proposes to extend the R&E tax credit for three years (through December 31, 1988). Since the credit would then expire after 1988, the revenue loss disappears in the long run.

In conclusion, the above provisions have long-run revenue effects that are likely to offset one another to some degree. The Congressional Budget Office has not made out-year revenue estimates of these provisions and has not determined whether their combined revenue effect grows faster or slower than GNP after 1986-1990. The corporate tax provisions that have been reviewed in this paper, however, are likely to raise significantly less revenue (relative to GNP) than indicated by their five-year revenue effect.

APPENDIX: THE CBO DEPRECIATION CALCULATOR

The depreciation calculator used here estimates the additional depreciation deductions available to business as a result of a change in the law governing tax depreciation. Total depreciation deductions under old and new law are estimated by depreciating individual vintages of each type of corporate capital good, using average annual depreciation factors appropriate for each depreciation system. The derivations of the depreciable bases and annual depreciation factors will be documented in detail in a future CBO staff paper, and are summarized below.

The depreciable bases for the depreciation calculator are derived from forecasts of the national income and product account (NIPA) measures of business fixed investment in producers' durable equipment (PDE) and nonresidential structures. The equipment base is increased to account for those business purchases of new autos which, under the definition of PDE, are offset by business sales of used autos to nonbusiness sectors. Nonresidential structures are increased to total business structures by adding an estimate of business purchases of residential structures. The equipment and structures bases are then divided into corporate and noncorporate portions, and the corporate share of structures is divided into utility property and real property. The resulting corporate depreciable bases for new capital goods are equipment, utility property, and real property. Changes in depreciation rules also apply to capital goods that change owners, so four more depreciable bases are independently estimated. These include used equipment and real property (pre-1981 capital goods which change hands and come under new law), and resold equipment and real property (post-1980 capital goods which change hands.) The unadjusted basis of used and resold structures is assumed to have increased at the same rate as the GNP deflator. Used and resold equipment is not assumed to appreciate with inflation.

Average tax lives under pre-1981 law, average depreciation factors under new law, and average statutory ITC rates under old and new law, are calculated using NIPA investment weights modified by considerable judgment. Assumptions about the distribution of depreciation methods are used to calculate annual depreciation factors under old law, given the average tax lives. Average statutory ITC rates are used to apply the ITC basis adjustment to depreciable equipment bases when appropriate. The GNP deflator is used to index the new law annual depreciation factors when the proposal includes indexing of depreciation deductions.

Technical Assumptions for the Depreciation Calculator

In 1986, corporations are assumed to own 77 percent of depreciable new equipment, 50 percent of depreciable used equipment, 100 percent of utility property, and 66 percent of depreciable real property. The total depreciable new equipment base is 106.1 percent of producers' durable equipment (and used autos equal to 6.1 percent of PDE are sold to nonbusiness

sectors after only one year in the depreciable base), utility property is 22.4 percent of nonresidential real structures, and new real property (including business purchases of residential property) is 86.4 percent of nonresidential structures.

The average ITC rate on equipment is 9.4 percent under ACRS. Twenty-five percent of equipment is assumed to be three-year equipment under ACRS, and class 1 equipment under the Administration's proposal. In the first year of the Administration's proposal, 19 percent of equipment would be class 2, 14 percent class 3, 38 percent class 4, and 3 percent class 5. Thirteen percent of utility property is assumed to be 10 year property under ACRS.

Forty percent of new real property is depreciated using the straight line alternative, which under current law avoids recapture of depreciation deductions upon resale. Real property for which straight line depreciation has been chosen under ACRS is assumed to be resold according to the following schedule: 10 percent in the seventh year, 20 percent in the eighth, 40 percent in the ninth, 20 percent in the tenth, and 10 percent in the eleventh year. Five percent of new equipment is assumed to be resold in the fifth year, and 15 percent in the sixth year, with the resale price equal to what the adjusted basis would have been under pre-1981 law.

Use of depreciation calculator results to calculate revenue estimates

The change in depreciation deductions estimated by the depreciation calculator is subtracted from a forecast of taxable profits before the depreciation change. The resulting estimate of taxable profits is further adjusted (as mentioned above) for the allocative effects of any dividends-paid deduction in the proposal. Taxable profits are then multiplied by the effective tax rate.

The effective tax rate on taxable profits is determined both by the statutory rate and by all provisions which reduce taxes without affecting the measurement of the taxable base. In the procedure used to make the revenue estimates presented here, an equation is estimated with liability after the foreign tax credit, but before the investment tax credit, as the dependent variable. The effective tax rate is the product of the maximum statutory rate and the coefficient of the independent variable which includes taxable profits and the statutory rate.

The resulting calendar year liability estimates are then distributed to a fiscal year unified budget basis.

Economic Assumptions

Projections of five aggregate economic variables are required to produce the revenue estimates presented here. For these estimates, the CBO

baseline projections of February 1985 were used for the first five years, and constant growth rates were assumed for the next 10 years. Those economic variables, their average annual growth rates between 1986 and 1990, and the average rates assumed for subsequent years, are shown below:

ECONOMIC ASSUMPTIONS
(average annual percent change, calendar years)

variable	1986-1990	1991-2000
GNP	7.7%	7.0%
GNP deflator	4.2	4.0
producers' durable equipment	8.7	7.0
nonresidential structures	7.2	7.0
economic profits	9.2	7.0