CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

September 23, 1998

H.R. 4579
Taxpayer Relief Act of 1998

As ordered reported by the House Committee on Ways and Means on September 17, 1998.

SUMMARY

The Taxpayer Relief Act of 1998 is an omnibus tax bill that would amend existing tax laws and extend numerous tax provisions that have expired recently or are about to expire. H.R. 4579 would also increase the amount that Social Security beneficiaries who are over the age of eligibility for full retirement benefits (currently 65) and under age 70 could earn without having their benefits reduced and would offset the resulting costs by delaying recomputations of benefits for recent earnings. The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) estimate that H.R. 4579 would decrease governmental receipts by $80 billion over the 1999-2003 period. In addition, CBO estimates that this bill would reduce spending for Social Security by $5 million over the same period.

H.R. 4579 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA) and would impose no costs on state, local, or tribal governments. The bill imposes one new private-sector mandate through changes in the treatment of certain deductible liquidating distributions of regulated investment companies and real estate investment trusts. The costs of the new mandate would exceed the threshold ($100 million in 1996, adjusted annually for inflation) specified in UMRA in fiscal years 1999-2003.

DESCRIPTION OF MAJOR PROVISIONS

Title I, Provisions Primarily Affecting Individuals and Families, would:

- Raise the standard deduction for married couples,
- Provide for a partial exclusion of income from interest and dividends,

- Change treatment of personal credits under the individual alternative minimum tax,

- Accelerate the increase in the deduction for health insurance expenses for self-employed individuals,

- Establish a special rule relating to gain on sale of principal residence for members of the uniformed forces and the foreign service serving outside the area where the property is located,

- Accelerate the increase in the unified credit in the estate and gift tax,

- Permit schools of higher education to establish qualified prepaid tuition programs,

- Change the treatment of tax-exempt bonds issued to finance public school construction,

- Increase the Social Security earnings limit for individuals who have attained retirement age, and

- Change the recomputation of benefits after normal retirement age.

Title II, Provisions Primarily Affecting Farming and Other Businesses, would:

- Accelerate the increase in expensing for small businesses,

- Permanently extend income averaging for farmers,

- Extend the net operating loss carryback period for farmers,

- Allow farmers not to include payments from production flexibility contracts in income prior to receipt, and

- Increase state volume limits on private activity tax-exempt bonds.

Title III, Extension and Modification of Certain Expiring Provisions, would:

- Extend the research and experimentation tax credit through February 29, 2000,

- Extend the work opportunity tax credit through February 29, 2000,

- Extend the welfare-to-work tax credit through February 29, 2000,

- Permanently extend the deduction provided for contributions of appreciated stock to private foundations,

- Modify and extend for one year the exemption from Subpart F for active financing income, and

- Extend the Generalized System of Preferences through February 29, 2000.

Title IV, Revenue Offset Provision, would change the treatment of certain deductible liquidating distributions of regulated investment companies and real estate investment trusts.

Title V would make technical corrections to existing tax laws.

Title VI, The American Community Renewal Act of 1998, would designate 20 renewal communities and provide various tax incentives.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 4579 is summarized in the following table. The costs of this legislation fall within budget function 650 (Social Security).

Table 1. Summary of Estimated Budgetary Effects of H.R. 4579

	By Fiscal Year, in Millions of Dollars					
	1998	1999	2000	2001	2002	2003
REVENUES						
Title I: Provisions Primarily Affecting Individuals and Families	0	-5,801	-16,505	-17029	-18,176	-18,634
Title II: Provisions Primarily Affecting Farming and Other Businesses	0	-734	-976	-383	-45	-153
Title III: Extension and Modification of Certain Expiring Provisions	0	-2,335	-1,944	-941	-576	-373
Title IV: Revenue Offset	0	2,425	1,109	723	640	672
Title VI: American Community Renewal Act	0	-3	-156	-256	-282	-343
Total	0	-6,448	-18,472	-17,886	-18,439	-18,831
DIRECT SPENDING						
Spending Under Current Law						
Old-Age, Survivors, and Disability Insurance[a]	375,785	391,477	408,764	427,736	448,711	471,221
Proposed Changes						
Old-Age, Survivors, and Disability Insurance[a]	0	165	85	10	-115	-150
Spending Under H.R. 4579						
Old-Age, Survivors, and Disability Insurance[a]	375,785	391,642	408,849	427,746	448,596	471,071
CHANGE IN SURPLUS						
Proposed Changes						
Off-Budget[a]	0	-165	-85	-10	115	150
On-Budget	0	-6,448	-18,472	-17,886	-18,439	-18,831
Total	0	-6,613	-18,557	-17,896	-18,324	-18,681

Sources: Joint Committee on Taxation and Congressional Budget Office.

Notes: Components may not sum to totals due to rounding. The table does not include any spending that may occur subject to appropriations as a result of federal deposits to the family development accounts, authorized in title VI.

a. Spending from the Old-Age and Survivors Insurance and Disability Insurance trust funds is off-budget under current law.

BASIS OF ESTIMATE

Revenues

All the estimates for the revenue provisions, with the exception of the Generalized System of Preferences (GSP) in subtitle B of title III, were provided by the JCT.

The Taxpayer Relief Act of 1998 would renew GSP, which expired on June 30, 1998, through February 29, 2000. Taxpayers could apply for refunds for the period between July 1, 1998, and October 1, 1998. GSP affords nonreciprocal tariff preferences to approximately 140 developing countries to aid their economic development and to diversify and expand their production and exports. Generally, duty-free treatment of imported goods from GSP-designated developing countries is extended to products that are not competitive internationally. The program contains safeguards to protect domestic industries that are sensitive to import competition. CBO estimates that renewing GSP would reduce governmental receipts by $393 million in fiscal year 1999, $142 million in fiscal year 2000, and a total of $535 million over the 1999-2000 period, net of payroll and income tax offsets. This estimate is based on projections of U.S. imports and recent data on collections from beneficiary countries under the GSP program.

Provisions Relating to Social Security

Subtitle C of title I contains two provisions relating to Social Security.

Earnings Limit. Section 121 of H.R. 4579 would increase the amount that certain Social Security beneficiaries could earn without having their benefits reduced. Under current law, for beneficiaries over retirement age (currently 65) and younger than age 70, one dollar of benefits is withheld for every three dollars of earnings above a threshold, which equals $14,500 in 1998. A stricter test applies to retired workers between the ages of 62 and 64; beneficiaries above the age of 70 are exempt. This year's limit of $14,500 was set two years ago in the Contract with America Advancement Act (Public Law 104-121), and will increase to $30,000 by 2002 and in step with average wages thereafter. This bill would raise the exempt amount of earnings in each of the next ten years except 2002 (see Table 2).

Table 2. Earnings Test for Certain Social Security Beneficiaries Under Current Law and H.R. 4579

Calendar Year	Exempt Amount Under Current Law[a]	Exempt Amount Under H.R. 4579	Difference	Affected Age Group
1998	$14,500	$14,500	$0	65 to 70
1999	15,500	17,000	1,500	65 to 70
2000	17,000	18,500	1,500	65 to 70
2001	25,000	26,000	1,000	65 to 70
2002	30,000	30,000	0	65 to 70
2003	31,200	31,300	100	65 and 2 months to 70
2004	32,520	34,000	1,480	65 and 4 months to 70
2005	33,840	35,400	1,560	65 and 6 months to 70
2006	35,160	36,800	1,640	65 and 8 months to 70
2007	36,600	38,350	1,750	65 and 10 months to 70
2008	37,920	39,750	1,830	66 to 70

a. Through 2002, these amounts are set in the Contract With America Advancement Act (Public Law 104-121). After 2002, they are indexed to overall wage increases. A lower limit applies to beneficiaries who have not reached the age for full (unreduced) retirement benefits.

In calendar years 1999 and 2000, CBO estimates that the proposed increase in the earnings limit would lead to extra Social Security outlays of about $225 million each year. Because the increase would not take effect until January 1999, the cost in fiscal year 1999 would be only about $175 million. In those years, based on information from the Social Security Administration (SSA), CBO estimates that about 500,000 beneficiaries would receive benefit increases. The maximum gain in those years for a beneficiary would be $500 (that is, the proposed $1,500 increase times the one-third reduction in benefits that the recipient would experience under current law); of course, not all of those affected would receive the maximum increase. The costs of the bill would fall after 2000 for several reasons. First, the retirement age is scheduled to increase under current law, effective for people reaching age 62 in 2000 (age 65 in 2003), and fewer people will be in the relevant age bracket. Second, the threshold for the earnings test is already scheduled to climb steeply under current law, and fewer people will exceed it. Finally, those older workers who benefit from this proposal will thereby forfeit a part of their delayed retirement credit for the rest of their lifetimes. In 2003, for example, when the proposed change in the earnings test itself is negligible, CBO estimates that about $10 million would be saved, on balance, by virtue of the delayed retirement credit (see Table 3).

Delay in Benefit Recomputations. Benefits for retired workers are essentially computed by averaging the highest 35 years of the worker's earnings and applying a benefit formula.

When a retiree continues to have earnings, SSA checks to see whether substituting that year of earnings--in lieu of one of the other 35 years--would lead to a higher benefit. Those recomputations are based on the annual earnings that employers report to the Internal Revenue Service. About 85 percent of such earnings are posted within 6 months of the close of the calendar year, and about 98 percent within 9 months. Because of this lag, recomputations--which are now effective for the January immediately after the year of earnings--typically lead to a lump-sum payment of retroactive benefits when they are finally processed.

Section 122 of H.R. 4579 provides that, in most cases, the recomputation would raise benefits effective in January of the second year following the earnings. That is, benefits for the year after the earnings were received would not reflect those earnings. H.R. 4579 would make an exception in cases where that latest year of earnings would substitute for a year of zero earnings in the beneficiary's previous high 35. The provision would apply only to beneficiaries who have reached retirement age and would be effective beginning with earnings in 1998. Because SSA would not have processed most of those recomputations until late in the fiscal year, savings in 1999 are estimated at just $10 million. Thereafter, the proposal is estimated to affect nearly 1 million beneficiaries a year for annual savings of $140 million.

Table 3. Estimated Budgetary Effects of Spending Provisions of H.R. 4579

	By Fiscal Year, in Millions of Dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Section 121. Increase earnings limit for Social Security beneficiaries over the age of retirement	175	225	150	25	-10	110	150	150	150	150
Section 122. Delay recomputation of benefits for certain Social Security beneficiaries over the age of retirement	-10	-140	-140	-140	-140	-140	-140	-140	-140	-140

Source: Congressional Budget Office
Note: These provisions would affect benefit outlays from the Old-Age and Survivors Insurance trust fund, which is off-budget.

PAY-AS-YOU-GO CONSIDERATIONS:

The Balanced Budget and Emergency Deficit Control Act of 1985 establishes pay-as-you-go procedures for legislation affecting direct spending or receipts. Only changes affecting on-budget outlays and receipts (that is, those in non-Social Security programs) affect the pay-as-you-go scorecard. For purposes of enforcing pay-as-you-go procedures, only the effects in the current year, budget year, and the succeeding four years are counted (see Table 4).

Table 4. Summary of Pay-As-You-Go Effects of H.R. 4579

	By Fiscal Year, in Millions of Dollars									
	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Change in Outlays	0	0	0	0	0	0	0	0	0	0
Change in Receipts	-6,448	-18,472	-17,886	-18,439	-18,831	-19,738	-18,620	-18,523	-19,119	-21,034

Sources: Congressional Budget Office and Joint Committee on Taxation

Social Security outlays and receipts do not appear on the pay-as-you-go scorecard, but the House of Representatives tracks them separately. That tally includes effects only for the year in which the legislation takes effect and the four subsequent years; for H.R. 4579, the relevant years are 1999 through 2003. The scorecard also includes balances carried over from laws enacted in previous years, such as the Contract with America Advancement Act, enacted in 1996 (see Table 5).

Table 5. CBO Estimate of Current Status of the Social Security Scorecard in the House of Representatives

	By Fiscal Year, in Millions of Dollars				
	1999	2000	2001	2002	2003
Scorecard at Start of 1999:					
OASDI Taxes	80	--	--	--	--
OASDI Benefits	-114	75	--	--	--
Net Effect	194	-75	--	--	--
Effect of Taxpayer Relief Act of 1998 (H.R. 4579):					
OASDI Taxes	--	--	--	--	--
OASDI Benefits	165	85	10	-115	-150
Net Effect	-165	-85	-10	115	150
Scorecard Assuming Enactment of H.R. 4579:					
OASDI Taxes	80	--	--	--	--
OASDI Benefits	51	160	10	-115	-150
Net Effect	29	-160	-10	115	150

Sources: Congressional Budget Office and Joint Committee on Taxation.
Note: OASDI = Old-Age, Survivors, and Disability Insurance.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

Section 4 of UMRA excludes from the application of that act any legislative provisions that relate to the old-age, survivors, and disability insurance program under title II of the Social Security Act. CBO has determined that all provisions of subtitle C of title I fit within that exclusion. CBO and JCT have determined that the remaining provisions of H.R. 4579 contain no intergovernmental mandates as defined in UMRA.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

JCT has determined that title IV would impose a new private-sector mandate on regulated investment companies and real estate investment trusts by changing the treatment of certain deductible liquidating distributions. The direct costs of the new mandate would exceed the statutory threshold ($100 million in 1996, adjusted annually for inflation) established in UMRA in each of fiscal years 1999 though 2003 (see Table 6). UMRA does not apply to the provisions of subtitle C of title I. The other provisions of H.R. 4579 contain no private-sector mandates.

Table 6. Estimated Cost of Private-Sector Mandates

	By Fiscal Year, in Millions of Dollars					
	1998	1999	2000	2001	2002	2003
Cost to the Private Sector	0	2,425	1,109	723	640	672

Source: Joint Committee on Taxation

ESTIMATE PREPARED BY:

Federal Spending: Kathy Ruffing and Deb Reis
Federal Revenues: Hester Grippando
Impact on State, Local, and Tribal Governments: Pepper Santalucia
Impact on the Private Sector: Lesley Frymier

ESTIMATE APPROVED BY:

Frank Sammartino
Assistant Director for Tax Analysis (Acting)

Paul N. Van de Water
Assistant Director for Budget Analysis