CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

October 17, 2001

H.R. 3090

Economic Security and Recovery Act of 2001

As ordered reported by the House Committee on Ways and Means on October 12, 2001

SUMMARY

H.R. 3090 would reduce tax receipts from corporations by increasing and extending certain deductions and exemptions and by repealing the alternative minimum tax. It also would provide a tax rebate to certain individual tax filers, accelerate the reduction of the prior-law 28 percent individual income tax rate to 25 percent in calendar years 2002 and thereafter, and reduce the rate at which capital gains are taxed for individuals. In addition, the bill would extend numerous tax credits and make certain other changes.

The Congressional Budget Office (CBO) and the Joint Committee on Taxation (JCT) estimate that H.R. 3090 would decrease governmental receipts by $69.7 billion in 2002, by $164.7 billion over the 2002-2006 period, and by $128.2 billion over the 2002-2011 period. In addition, the bill would increase direct spending by $31.5 billion in 2002 and $2.7 billion in 2003. In total, H.R. 3090 would reduce projected total surpluses by an estimated $162 billion over the 2002-2011 period. Because the bill would affect receipts and direct spending, pay-as-you-go procedures would apply.

The review of H.R. 3090 by JCT and CBO identified no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). CBO reviewed four sections of the bill (sections 103, 310, 402, and 501), two of which would provide benefits to state governments: one by accelerating transfers of funds to state accounts for unemployment compensation benefits, and another by providing grants to states for health insurance assistance to unemployed individuals.

JCT has determined that the provisions that limit use of the non-accrual experience method of accounting and that alter the treatment of discharge of indebtedness of an S corporation contain private-sector mandates. CBO has determined that section 310 of the bill, which extends the provisions of the Mental Health Parity Act, contains a private-sector mandate. CBO and JCT estimate that the direct cost of the private-sector mandates in the bill would exceed the annual threshold established by UMRA ($113 million in 2001, adjusted for inflation) in each of the years that the mandates would be effective.

MAJOR PROVISIONS

Title I, entitled *Business Provisions*, would:

- Allow taxpayers to deduct an additional 30 percent of the value of certain qualifying capital assets and software in the first year if such property is placed in service before January 1, 2005;

- Increase the maximum dollar amount that may be deducted on qualifying property in lieu of depreciation from $24,000 ($25,000 in taxable years beginning after 2003) to $35,000 for property placed in service after December 31, 2001, and before January 1, 2004, and increase the beginning point at which such treatment is phased out to $325,000 before January 1, 2004;

- Allow taxpayers to depreciate certain improvements to leasehold property over 15 years;

- Extend to five years the period in which taxpayers may carry back net operating losses in taxable years arising on or after September 11, 2001, and ending before September 11, 2004;

- Repeal the corporate Alternative Minimum Tax (AMT) and make the AMT credit refundable; and

- Extend permanently the deferral of certain active financing income of multinational businesses.

Title II, entitled *Individual Provisions*, would:

- Accelerate the reduction of the prior-law 28 percent individual income tax rate to 25 percent in calendar year 2002 and thereafter;

- Increase the AMT exemption amount for individuals for taxable years beginning after December 31, 2001, and before January 1, 2005;

- Increase the deduction of capital losses of individuals against ordinary income from $3,000 to $4,000 for taxable year 2001, and to $5,000 for taxable year 2002;

- Reduce the tax rates on the adjusted net capital gain of an individual from 20 percent and 10 percent to 18 percent and 8 percent, respectively, and repeal the special rules for certain gain from property held more than five years; and

- Expand the exception to the tax on early withdrawal of IRA distributions to distributions used for health insurance by unemployed individuals if those distributions were made by individuals between September 11, 2001, and December 31, 2002.

Title III, entitled *Extensions of Certain Expiring Provisions*, would:

- Allow an individual to offset all regular tax liability and AMT liability by personal nonrefundable credits in 2002 and 2003;

- Extend several tax credits for two years, including the work opportunity tax credit and the welfare-to-work tax credit;

- Allow new contributions to be made to Archer medical savings accounts through December 31, 2003, for those individuals who would no longer be able to contribute under current law;

- Extend the Mental Health Parity Act of 1996, which expired September 30, 2001, for an additional 2 years;

- Limit the use of the experience method of accounting; and

- Provide that income from the discharge of indebtedness of an S corporation not be taken into account as an item of income by any shareholder.

Title IV, entitled *Supplemental Rebate; Other Provisions*, would:

- Provide an additional rebate to those taxpayers who filed income tax returns for 2000 if they were eligible for rebates under the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and did not receive the maximum rebate amount under that act; and

- Accelerate transfers from the federal unemployment accounts to the state accounts in the unemployment trust fund.

Title V, entitled *Health Care Assistance for the Unemployed*, would increase by $3 billion Social Services Block Grants to states for health care assistance for the unemployed.

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 3090 is shown in the following table. Most of the budgetary effects of the legislation are reductions in revenues. However, enacting the bill also would increase outlays by making the AMT credit refundable and by providing additional rebates to some taxpayers who were eligible for rebates under EGTRRA. Enacting H.R. 3090 also would increase outlays by accelerating transfers from the federal unemployment accounts to the state accounts in the unemployment trust fund. In addition, outlays would result from new grants to states for health insurance coverage for the unemployed. The spending effects of this legislation would fall within budget functions 500 (education, training, employment, and social services), 600 (income security), and 800 (general government).

BASIS OF ESTIMATE

Revenues

All the estimates for the revenue provisions, with the exception of the provision relating to unemployment trust fund revenues (detailed in the direct-spending section) and the provision relating to the extension of the Mental Health Parity Act of 1996 (detailed in the discussion of the private-sector impact), were provided by the JCT.

Of the provisions estimated by the JCT, four provisions would comprise the majority of the changes in revenues if H.R. 3090 were enacted. The provisions that allow taxpayers to deduct an additional 30 percent of the value of certain assets, repeal the alternative minimum tax, extend permanently the deferral of certain active financing income of multinational businesses, and accelerate the reduction of the prior-law 28 percent individual income tax rate to 25 percent in calendar year 2002 would, if enacted, reduce revenues by an estimated $61.7 billion in 2002, $143.1 billion over the 2002-2006 period, and $100.9 billion over the 2002-2011 period.

Direct Spending

Allow Corporations to Treat Alternative Minimum Tax Credits as Refundable. Under current law, if a corporation is subject to the AMT in any year, the amount of the AMT is allowed as a credit against income in any subsequent taxable year if the regular tax liability exceeds a certain amount. Under H.R. 3090, if the AMT credit exceeded the taxpayer's 2001 tax liability, the taxpayer would receive the excess as a refund. CBO considers that excess to be an outlay. CBO expects that all refunds of the credit—totaling $16.1 billion—would be made in 2002, and that there would be no future outlays for this purpose as the AMT would be repealed under the bill.

ESTIMATED BUDGETARY IMPACT OF H.R. 3090

	By Fiscal Year, in Millions of Dollars				
	2002	2003	2004	2005	2006
CHANGES IN REVENUES					
Title I: Business Provisions	-54,981	-42,502	-33,822	9,957	25,296
Title II: Individual Provisions	-14,204	-18,694	-13,179	-10,050	-4,465
Title III: Extensions of Certain Expiring Provisions	-490	-2,295	-2,490	-1,818	-1,946
Title IV: Supplemental Rebate; Other Provisions	-0	100	300	300	300
Total Changes in Revenues	-69,675	-63,391	-49,191	-1,611	19,185
On-Budget	-69,670	-63,383	-49,188	-1,611	19,185
Off-Budget	-5	-8	-3	0	0
CHANGES IN DIRECT SPENDING					
Outlays for Refundable AMT Credit	16,068	0	0	0	0
Outlays for Supplemental Rebate	13,733	0	0	0	0
Accelerated Transfer to State Unemployment Trust Fund[a]	700	700	0	0	0
Increase in Social Services Block Grant	1,000	2,000	0	0	0
Total Changes in Direct Spending Outlays	31,501	2,700	0	0	0
Net Increase or Decrease (-) in the Budget Surplus	-101,176	-66,091	-49,191	1,611	19,185

SOURCES: Joint Committee on Taxation and Congressional Budget Office

a. Under more realistic assumptions about likely unemployment in the near term, CBO would expect the increase in outlays to be greater in the short term—totaling about $4.5 billion in fiscal years 2002 and 2003. However, this increase in spending would be completely offset by revenue increases and by reduced spending in the following seven fiscal years.

Supplemental Rebate. The bill would provide an additional rebate to those taxpayers who filed a tax return for 2000 and were eligible for payment under the advance refund mechanism in EGTRRA but who did not receive the maximum amount ($300 for individual taxpayers or married taxpayers filing separately, $500 for taxpayers filing as heads of households, and $600 for married taxpayers filing jointly). Under normal budgetary procedures, the amount of a rebate or refundable tax credit that exceeds an individual's tax liabilities is considered a form of spending, rather than an offset to revenues. This supplemental rebate falls in spending category because, under current law, taxpayers have received (in 2001) or will receive (in 2002) credits allowed under EGTTRA at least up to the amounts of their 2001 tax liabilities. Thus, the supplemental rebates represent amounts in excess of individuals' tax liabilities for 2001 and should be classified as outlays.

JCT estimates that the additional refunds will total about $13.7 billion. CBO expects that all outlays would be made in fiscal year 2002.

Transfers from Federal Unemployment Accounts. Section 402 of the bill would accelerate transfers from the federal unemployment accounts to the state accounts in the unemployment trust fund. CBO estimates that roughly $40 billion of these transfers could be anticipated over the 2002-2011 period under provisions of current law. The bill would provide for the immediate transfer of $9.3 billion from federal accounts to the state accounts in the unemployment trust fund, amounts that the states otherwise would receive during the 2003-2005 period. States would be allowed to spend those funds on unemployment compensation or on administrative costs associated with unemployment and employment services.

CBO expects that states would spend a portion of these funds in fiscal years 2002 and 2003. Under the economic assumptions underlying the budget resolution, the additional outlays are estimated to total $1.4 billion over the next two years. If unemployment rates were to approach 6.0 percent in 2002, CBO estimates the additional spending would be somewhat higher—about $4.5 billion—during the 2002-2003 period. However, over the longer run, this additional spending would be completely offset by increases in state revenues and by some reductions in spending. The offsets in future years occur because the reserve ratios in the state trust funds (the amount of funds kept on hand to pay future benefits) are assumed to remain in balance. Therefore, increased spending in the short term would be offset by decreased spending or increased revenues in the longer term. Thus, speeding up the transfer would have no net cost over the 2002-2011 period.

Health Care Coverage for the Unemployed. Section 501 would increase the amount of the Social Services Block Grant by $3 billion in 2002 to provide health care coverage for the unemployed. The money would be allocated to states based on their population. States could use the money to provide health coverage for individuals (or family members of such individuals) who qualify for unemployment benefits in calendar year 2001 or later, and are not otherwise eligible for federal health coverage.

CBO expects that it would take several months for states to establish eligibility criteria and delivery mechanisms for the new services. CBO projects that $1 billion would be spent in 2002 and $2 billion in 2003.

PAY-AS-YOU-GO-CONSIDERATIONS

The net changes in outlays and governmental receipts that are subject to pay-as-you-go procedures are shown in the following table. For the purposes of enforcing pay-as-you-go procedures, only the effects in the current year and the succeeding four years are counted.

	By Fiscal Year, in Millions of Dollars									
	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Changes in receipts	-69,665	-63,381	-49,191	-1,611	19,185	15,841	11,762	7,160	2,804	-1,043
Changes in outlays	31,501	2,700	0	0	0	0	0	0	0	0

IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

H.R. 3090 contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA). Two of the provisions reviewed by CBO would provide benefits to state governments.

Section 402 of the bill would accelerate transfers from federal accounts in the unemployment trust fund to state unemployment compensation accounts. States would be able to use these additional funds, estimated to total $9.3 billion, for the payment of regular unemployment benefits as established in state laws or for the payment of new benefits established at the option of the state through March 11, 2003.

Section 501 of the bill would provide $3 billion to states through the Social Services Block Grant program to help unemployed individuals acquire health care coverage. The funds could not be used to supplant any other federal, state, or local funds that are used for health care coverage. In order to be eligible for assistance, an individual could not be eligible for any other federal health coverage.

IMPACT ON THE PRIVATE SECTOR

CBO and JCT estimate that the cost of the private-sector mandates in the bill would exceed the annual threshold established by UMRA ($113 million in 2001, adjusted for inflation) in each of the years that the mandates would be effective.

Mental Health Parity. Section 310 would extend the provisions of the Mental Health Parity Act of 1996, which expired on September 30, 2001, for an additional two years. That act prohibited group health plans that provide both medical and surgical benefits and mental health benefits from imposing aggregate lifetime limits or annual limits for coverage of mental health benefits that are different from those used for medical and surgical benefits. CBO estimates that the direct cost of the private-sector mandate in section 310 would be $270 million in fiscal year 2002 and $400 million in fiscal year 2003.

CBO estimates that the provision, if enacted, would increase premiums for group health insurance by an average of 0.1 percent, before accounting for the responses of health plans, employers, and workers to the higher premiums under the bill. CBO assumes that 60 percent of the potential impact of the mandate would be offset by behavioral responses, such as reductions in the number of employers offering insurance to their employees and in the number of employees enrolling in employer-sponsored insurance, changes in the types of health plans that are offered, and reductions in the scope or generosity of health insurance benefits. The remaining 40 percent of the potential increase in costs, or about 0.04 percent of group health insurance premiums, would occur in the form of increased outlays for health insurance. Those costs would be passed through to employees of private firms, reducing both their taxable compensation and other fringe benefits. CBO estimates that the resulting reduction in taxable income would be $76 million in calendar year 2002 and $85 million in calendar year 2003.

Those reductions in workers' taxable compensation would lead to lower federal tax revenues. CBO estimates that, as a result of the mental health parity provisions, federal tax revenues would fall by $20 million in fiscal year 2002, by $30 million in 2003, and by $10 million in 2004 if H.R. 3090 were enacted. Social Security payroll taxes, which are off-budget, would account for about 30 percent of the total.

Other Mandates. Section 341 of the bill would provide that income from the discharge of indebtedness of an S corporation that is excluded from the S corporation's income is not taken into account as an item of income by any shareholder and thus does not increase the basis of any shareholder's stock in the corporation.

Under Section 342, the experience method of accounting would be available only for amounts to be received for the performance of qualified services and for services provided by certain small businesses.

JCT estimates that those private-sector mandates in the bill would exceed the annual threshold established by UMRA ($113 million in 2001, adjusted for inflation) in each of the years that the mandates would be effective.

ESTIMATE PREPARED BY:

Federal Revenues: Erin Whitaker and Alexis Ahlstrom
Transfers to State Unemployment Trust Funds: Christi Hawley Sadoti
Health Care Coverage for the Unemployed: Sheila Dacey
Impact on State, Local, and Tribal Governments: Leo Lex
Impact on the Private Sector: Jen Bullard Bowman

ESTIMATE APPROVED BY:

G. Thomas Woodward
Assistant Director for Tax Analysis

Robert A. Sunshine
Assistant Director for Budget Analysis