CONGRESSIONAL BUDGET OFFICE
COST ESTIMATE

March 5, 2003

H.R. 878
Armed Forces Tax Fairness Act of 2003

As ordered reported by the House Committee on Ways and Means on February 27, 2003

SUMMARY

H.R. 878, the Armed Forces Tax Fairness Act of 2003, would raise the exclusion for death gratuity payments for the military and provide military and foreign service homeowners with relief from capital gains taxes. In addition, the bill would provide individual taxpayers serving in the National Guard and Reserve with a deduction for up to $500 dollars of certain overnight travel expenses, including meals and overnight lodging, incurred while attending National Guard and Reserve meetings. The bill contains several miscellaneous provisions that would also reduce revenues. In addition, the bill would raise revenue by modifying the tax treatment of individuals who expatriate and by adding Hepatitis A to the list of taxable vaccines. H.R. 878 would increase on-budget federal outlays and reduce off-budget outlays by the same amounts by requiring a new general fund payment to the Social Security trust funds to replace any loss of payroll taxes that would result from the bill.

The Joint Committee on Taxation (JCT) estimates that enacting the bill would reduce revenues by $74 million in 2003, by $401 million over the 2003-2008 period, and by $615 million over the 2003-2013 period. CBO estimates that the bill would have no effect on total direct spending, but it would both increase on-budget direct spending and decrease off-budget direct spending by $5 million over the 2003-2008 period, and by $10 million over the 2003-2013 period.

JCT has determined that the bill contains no intergovernmental mandates as defined in the Unfunded Mandates Reform Act (UMRA), and would not affect the budgets of state, local, or tribal governments. JCT has also determined that the provision revising the alternative tax regime for individuals who expatriate contains a private-sector mandate. The total cost of complying with the mandate would not exceed the threshold established by UMRA ($117 million in 2003, adjusted annually for inflation).

ESTIMATED COST TO THE FEDERAL GOVERNMENT

The estimated budgetary impact of H.R. 878 is shown in the following table.

	By Fiscal Year, in Millions of Dollars					
	2003	2004	2005	2006	2007	2008
CHANGES IN REVENUES						
Tax relief from capital gains for military and foreign service homeowners	-66	-13	-14	-14	-15	-16
Above-the-line deduction for up to $500 of overnight travel expenses	-4	-19	-19	-19	-19	-19
Other tax relief for military personnel	-11	-4	-4	-4	-5	-6
Expansion of human clinical trials expenses qualifying for orphan drug tax credit	-6	-15	-16	-16	-17	-18
Modification of tax treatment of individuals who expatriate	3	16	18	21	24	28
Add Hepatitis A to the list of taxable vaccines	3	8	9	9	9	9
Other provisions	7	-37	-60	-39	-33	-32
Total Changes						
On-budget	-74	-63	-85	-61	-55	-53
Off-budget	*	-1	-1	-1	-1	-1
Total	-74	-64	-86	-62	-56	-54
CHANGES IN DIRECT SPENDING						
On-budget	*	1	1	1	1	1
Off-budget	*	-1	-1	-1	-1	-1
Total	0	0	0	0	0	0

SOURCES: CBO and the Joint Committee on Taxation.

NOTES: * = Change of less than $500,000.
Details do not add to totals due to rounding.

BASIS OF ESTIMATE

Revenues

All estimates were provided by JCT. A number of provisions would reduce revenues if enacted, and two would increase revenues. All together, the bill's provisions would reduce revenues by $74 million in 2003, by $401 million over the 2003-2008 period, and by $615 million over the 2003-2013 period.

H.R. 878 contains nine provisions intended to provide tax relief for military personnel, seven of which would reduce federal receipts. Most of the reduction in revenues would occur from the provisions providing military and foreign service homeowners relief from taxation of capital gains and reservists with a deduction allowance for up to $500 of travel expenses. The deduction for qualifying travel expenses would be "above the line." Such deductions are statutorily allowed subtractions from gross income that are used to compute adjusted gross income and may be taken by both taxpayers who itemize their deductions and those who do not. Other tax relief for military personnel includes provisions that would raise the exclusion for death gratuity payments for individuals in the military, provide an exclusion for amounts received under the Department of Defense (DOD) Homeowners Assistance Program, expand combat zone filing rules to include contingency operations, extend section 501(c)(19) membership to certain relatives of military personnel, and permit service academy appointments to be treated as scholarships for certain purposes. As estimated by JCT, all of these provisions together would reduce revenues by $81 million in 2003, by $273 million over the 2003-2008 period, and by $482 million over the 2003-2013 period. A small portion of those reductions would apply to off-budget receipts. The exclusion for amounts received under the Homeowners Assistance Program would reduce off-budget receipts by $5 million over the 2003-2008 period and by $10 million over the 2003-2013 period.

In addition to the above provisions intended to provide tax relief for military personnel, H.R. 878 contains fourteen other miscellaneous provisions that would also affect federal receipts. Of these, the provision expanding human clinical trials that qualify for the orphan drug tax credit would have the largest effect on revenues. JCT estimates that, together, these miscellaneous provisions would decrease revenues by $283 million over the 2003-2008 period and by $552 million over the 2003-2013 period.

Two other provisions contained in H.R. 878 would both increase revenues. JCT estimates that these provisions, which would modify the tax treatment of individuals who expatriate and add Hepatitis A to the list of taxable vaccines, would increase revenues by $6 million in 2003, by $155 million over the 2003-2008 period, and by $419 million over the 2003-2013 period.

Direct Spending

Section 214 of the bill would require that amounts transferred to the Social Security trust funds be determined as if H.R. 878 were not enacted. The Treasury Department transfers the estimated amount of payroll tax collections to the trust funds as the withholding payments are received. CBO and JCT estimate that providing an exclusion for amounts received under the Department of Defense Homeowners Assistance Program would reduce Social Security revenues by $1 million in each of the years from 2004 through 2013. Therefore, CBO estimates that comparable amounts would be transfered to the Social Security trust funds during those years as a result of section 214. Those transfers would be recorded as on-budget outlays and off-budget receipts.

EFFECT ON REVENUES AND DIRECT SPENDING

The overall effect of H.R. 878 on on-budget revenues and direct spending is shown in the table below.

	By Fiscal Year, in Millions of Dollars										
	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013
Changes in receipts	-74	-63	-85	-61	-55	-53	-51	-48	-38	-35	-38
Changes in outlays	0	1	1	1	1	1	1	1	1	1	1

SOURCES: CBO and the Joint Committee on Taxation.

ESTIMATED IMPACT ON STATE, LOCAL, AND TRIBAL GOVERNMENTS

JCT has determined that the bill contains no intergovernmental mandates as defined in UMRA, and would not affect the budgets of state, local, or tribal governments.

ESTIMATED IMPACT ON THE PRIVATE SECTOR

JCT has determined that the provision revising the alternative tax regime for individuals who expatriate contains a private-sector mandate. The total cost of complying with the mandate would not exceed the threshold established by UMRA ($117 million in 2003, adjusted annually for inflation).

PREVIOUS CBO ESTIMATE

On February 10, 2003, CBO transmitted a cost estimate for the Armed Forces Tax Fairness Act of 2003, as ordered reported by the Senate Committee on Finance. That version of the bill would reduce increase revenues by $6 million over the 2003-2013 period, whereas the Committee on Ways and Means' version of the bill has an estimated revenue loss of $615 million over the same period. A major difference is the inclusion of additional revenue-reducing provisions in the Ways and Means' version. Another significant difference is the inclusion of several revenue-raising provisions in the Finance Committee's version, namely the extension of IRS user fees and imposition of a mark-to-market tax on individuals who expatriate. The Ways and Means' version imposes a more limited penalty for expatriation.

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