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FEDERAL BUDGET ISSUE

Bush vs. The Congressional Democrats: Whose Tax Plan Is Better?

In his State of the Union message, President Bush proposed a new tax package which he said would promote economic growth and create jobs. With unusual assertiveness, he gave Congress one month to enact his package.

"Neither side produced an 'official' forecast showing that their plan would create a single job."

The Democrats in Congress met the president's March 20, 1992 deadline, but with their own tax package. The vote was almost totally along party lines with no attempt at compromise. The Democrats passed a package which they knew the president would veto, and he obliged.

Almost everyone agrees that this highly partisan exercise had no real purpose other than allowing Washington politicians to position themselves for the November elections. That is unfortunate. We need a real economic growth package for the remainder of the decade.[1] Clearly, this year we will not get one.

Partisan Rhetoric and Faulty Forecasts. One of the strangest features of the congressional debate was the stark contrast between the rhetoric of the debaters and the numbers produced by their economists. Both sides claimed their tax package would stimulate investment and create jobs. Yet neither side produced an "official" forecast showing that their plan would add a single dollar of investment or create a single job.

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For the most part, the Democrats rely on the economists at the Joint Committee on Taxation (JCT) and the Congressional Budget Office (CBO). Yet:

- Despite the fact that the Democrats' package contained a capital gains tax cut, both the CBO and the JCT have routinely denied that a cut in the capital gains tax rate would cause more investment and more jobs.[2]

- Despite the fact that the Democrats' package contained new incentives to invest in equipment, the CBO and the JCT have routinely denied that tax incentives to invest produce more investment.

- Thus while the Democratic leadership argued that their plan would stimulate the economy, their own economists did not support that belief.

A similar problem exists on the Republican side. President Bush and many congressional Republicans rely on economists in the Treasury Department and at the Office of Management and Budget (OMB). Yet:

- Despite the fact that congressional Republicans have long argued that a capital gains tax cut would stimulate investment, Treasury Department economists have never supported that view.[3]

- In fact, throughout the recent congressional debate, neither OMB nor the Treasury produced a forecast showing that the president's plan would create a single new job.

"Inside-the-Beltway economists tend to assume that tax cuts do no good and tax increases do no harm."

Although they answer to bosses from different political parties, the economists at the CBO, JCT, OMB and Treasury Department all tend to be of one mind. They have a "static" view of the world in which tax cuts do no good and tax increases do no harm.[4] Despite a decade of overwhelming evidence that supply-side penalties and rewards have a huge impact on economic behavior, these economists maintain that tax incentives don't matter.

The View From Outside Washington. The Democrats' economists do not believe that Lloyd Bentsen's tax incentives will stimulate the economy any more than they believe that John Kennedy's tax incentives did. The Republicans' economists do not believe that George Bush's tax cuts will stimulate the economy any more than they believe that Ronald Reagan's did.

When the participants in a major debate base their arguments on numbers and forecasts produced by people who disagree with those arguments, the best

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ordinary citizens can do is ignore both the rhetoric and the "official" numbers. Increasingly, the private sector outside of Washington is providing a more realistic appraisal of what is going on.

Over the past several years, the National Center for Policy Analysis in conjunction with Fiscal Associates has produced forecasts of most major tax and spending bills before Congress. These forecasts are based on a *dynamic* model — which recognizes that incentives affect behavior. They are also based on an *accurate* model — which explains changes in investment spending over time. In what follows, we use the model to analyze the effects of the competing tax proposals.[5]

The Two Bush Proposals

Precisely because President Bush relies for economic advice on people who do not believe in the arguments he is making, the president was in trouble on his tax plan from day one.

"When the Republicans refused to introduce Bush's original plan, Democratic leader Dick Gephardt introduced it."

The details of President Bush's new economic plan were made public about a week after his State of the Union message. House Republicans, who had responded favorably to the President's speech, when they saw the fine print refused to endorse the plan. Instead, they devised their own plan — which the president adopted as his "fast track" proposal.

When no Republican would introduce the president's original proposal, Democratic leader Dick Gephardt (D-MO) did so. And in an obvious attempt to embarrass the Republicans, the Democrat-dominated House Ways and Means Committee reported the President's original plan to the floor of the House — forcing the full chamber to vote on it. The plan failed 427 to 1.

Bush I. As outlined in the State of the Union message, the key elements of the Bush proposal are: (1) a lowering of the maximum capital gains tax rate from 28 percent to 15.4 percent;[6] (2) new incentives for investment in equipment;[7] (3) restoration of the right to make deposits to Individual Retirement Accounts (IRAs), including the right to make aftertax deposits and tax-free withdrawals;[8] (4) a $500 increase in the personal exemption for dependent children; and (5) other provisions, including a tax credit for first-time home buyers,[9] the removal of certain passive loss restrictions in real estate[10] and the repeal of the luxury tax[11] on boats and planes.[12] When the details of this proposal were made public, the House Republicans balked — for good reasons.

- Whereas the president had promised a 15.4 percent capital gains tax, application of the alternative minimum tax would make the rate for people with a large capital gain at least 24 percent and possibly as high as 30 percent.[13]

- Whereas the president had promised to restore the opportunity to make deposits to IRAs, this right would be limited by income — denying the opportunity to those most likely to take advantage of it.[14]

- Whereas the president had promised new incentives for investments in equipment, the actual tax cut was about one-tenth of what others had proposed and was also temporary — lasting for only 17 months.[15]

- Whereas the president had promised special relief for the real estate industry, "recapture rules" in the fine print took away much of the value of the capital gains tax cut for sales of real property.[16]

- The president's plan also would have eliminated the tax-free buildup in life insurance and the tax advantages of annuities — provisions which would have threatened the financial health of an already weakened insurance industry.

"The president promised to cut the capital gains tax rate in half, but two-thirds of the tax cut was taken back in the fine print."

House Republicans were especially upset over the provisions on capital gains. Orally the president had promised to cut the tax rate almost in half. In the fine print, two-thirds of the tax cut was taken back through the application of the alternative minimum tax.

Bush II. The House Republicans faced a daunting political task. They had to rewrite the President's proposal to make it genuinely "pro-growth." At the same time, their new plan had to have enough in common with Bush I that the president could claim it as a fast-track version of his own. Among other changes, the House Republicans:

- Made the 15.4 percent capital gains tax rate real, rather than illusory, and made it fully applicable to the sale of real estate and closely held businesses.[17]

- Dropped the provisions allowing expanded IRA deposits and dropped the repeal of the luxury tax on boats and airplanes.

- Dropped the $500 increase in the personal exemption (for which the president paid a heavy price in the New Hampshire primary).

Note that the $500 increase in the personal exemption simply would have transferred income from government to taxpayers. While perhaps a good idea in its own right, it also would increase the deficit and have no effect on incentives to work or invest. It is not clear why the House Republicans dropped the President's IRA proposal — which has been endorsed by many Republicans without the income limits. Repeal of the luxury tax was probably dropped for political reasons, although this tax has been especially harmful. By one estimate, the luxury tax destroys one job for every $1,073 of revenue collected.[18]

"The most difficult task for the House Republicans was to find all of the ways in which the Treasury staff additions had subverted the president's goals."

The Republicans' most difficult task was to search through the fine print in the president's budget to find the many provisions added by the U.S. Department of Treasury staff that subverted the President's goals. At one point, the Republicans even added statutory language to the effect that investors could not be made worse off as a result of the package.

Key Elements of Bush II (The House Republicans' Plan)

The final version of the House Republicans' plan is analyzed below.

Capital Gains. Because of indexing, wage earners cannot be pushed into a higher tax bracket by the effects of inflation alone. Savers do not have similar protection, however. People who sell assets are forced to pay taxes on inflation-created profits even if the real profit is zero or negative.

For example, an asset purchased in 1978 for $1,000 would be worth $2,000 today if its value increased with the rate of inflation. Yet an owner who sold the asset for $2,000 would be taxed on a gain of $1,000 even though the value of the asset had not changed in real terms. Current law, then, discourages people from investing — especially in assets with lengthy productive lives. A capital gains tax cut is designed to partially correct this distortion and encourage future investment.

An unfortunate element of the president's original plan was retained by the House Republicans — the capital gains tax rate is staggered, declining with the length of time an asset is held. The rates would be 23.8 percent, 19.6 percent and 15.4 percent for assets held one, two and three years, respectively. This has the effect of lowering the average marginal tax rate to about 19 percent rather than 15.4 percent.

A staggered rate is common to many capital gains reform proposals. The argument is that people should be encouraged to invest in long-lived assets. But this argument confuses two separate issues: (1) the life of an asset and (2) the length of time an owner holds the asset. The tax law does discriminate against long-lived assets and this discrimination should be removed. However, once a person invests in such assets, there is no economic reason for us to care how long he or she holds it.

Investment in Equipment. The tax code also fails to index the depreciation of productive assets so that the write-offs keep up with inflation. In a period of no inflation, the tax law is reasonably fair. But if inflation averages 5 percent a year, a company must spend 50 percent more to replace a machine after eight years. This means the company must earn additional income and pay additional taxes equal to about one-fourth of the replacement cost.

The House Republican plan partially deals with this problem by adopting the president's proposal to speed up the deduction allowed for tax depreciation. This solution is still modest, however. Neutral cost recovery[19] or a 10 percent investment tax credit would be ten times as effective.

Provisions for Real Estate. From the president's original plan, the House Republican proposal retains four measures designed to stimulate real estate markets. These measures are: (1) a tax credit for first-time home buyers, (2) the right to make tax-free withdrawals from an IRA to purchase a home, (3) the removal of passive loss restrictions for real estate investors and (4) provisions that would make it easier to invest pension funds in real estate.

Paying for the Republican Plan. The plan proposes to: (a) increase minimum private pension plan funding requirements to limit exposure of the federal insurance program that guarantees the retiree benefits of failed plans,[20] (b) extend the statute of limitations for collecting on defaulted student loans and (c) eliminate the lump-sum retirement distribution option available to participants in the federal civil service retirement program. The majority of these changes — $20 billion over 1992 through 1997 — come from private pension plan reforms, which reduce the accrual of future government pension liabilities but do not reduce current outlays. Because this practice departs from prior government accounting procedures, we have ignored it in our deficit calculations.

"The House Republican plan will pay for itself, even without the accounting gimmicks the Republicans use to 'finance' it."

The Congressional Democrats' Plan

The Democratic leadership in Congress devised an alternative economic plan. It combines some pro-growth elements (including some version of all of the president's major proposals) with other elements that are anti-growth.

"Pro-growth elements in the Democrats' plan are more than offset by the negative effects of higher taxes on investment income."

Capital Gains. Like the Republicans, the congressional Democrats have acknowledged the need for capital gains tax reform. The House Democrats' proposal went right to the heart of the most fundamental problem: gains produced by inflation. The proposal would have indexed capital gains — thus eliminating the taxation of inflationary gains.

The final compromise proposal went in the direction preferred by Senate Democrats. For assets held for more than two years, the proposal would lower the capital gains tax rate from 15 percent to 5 percent for low- and moderate-income taxpayers. However, for higher-income taxpayers ($140,000 or more on a joint return) the rate would remain at 28 percent. Thus the proposal would do nothing for those most likely to have investment income and would lower tax rates for those least likely to have it.

Investment in Equipment. In recognition of the need to create new incentives, the Democrats adopted the Bush proposal to accelerate first-year depreciation for investment in equipment.

Flexible IRAs. The strongest pro-growth element in the Democrats' plan was the restoration of the right to make deposits to Individual Retirement Accounts. Alternatively, people would have the option of making *aftertax* deposits to IRAs and withdrawing the funds tax free at the time of retirement. An earlier NCPA study found that this proposal by itself would create 91,000 jobs over five years, creating enough new investment and therefore generating enough new tax revenues to pay for itself.[21]

Middle-Class Tax Reduction. In an effort to create middle-class tax benefits, the Democrats proposed to lower the 1992 and 1993 FICA payroll tax by 2 percentage points for low-income workers. This tax reduction would be phased out for middle-income families, beginning at an income level of $50,000. Although the proposal would lower the marginal payroll tax for low-income workers, it would increase marginal tax rates for middle-income workers. [See Table I.] For example:

- For a single worker, the marginal payroll tax rate would be increased by 0.75 percentage points.
- If the worker were married, the marginal tax rate would be increased by 1.5 percentage points.
- This would increase the marginal payroll tax rate on middle-income workers by 18 percent.

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"*Contrary to the rhetoric, the Democrats' proposal imposes the highest marginal tax rates not on 'the rich' but on middle-income families with children.*"

TABLE I

Higher Marginal Payroll Tax Rates, 1992 - 93

(Couple's Income: $50,000 to $70,000)

New Tax Rate	**9.05%**
Current Payroll Tax Rate	**7.65%**
Increase in Rate	**1.50%**

Beginning in 1994, the proposal would create a $300 tax credit for each child under age 16 for families with income less than $50,000. The credit would phase out between $50,000 and $70,000 of income. Over that range, the marginal tax rate on family income would increase by 1.5 percentage points per child. [See Table II.] Thus:

- A family in the 15 percent tax bracket with 10 children could see its marginal tax rate climb to 30 percent.
- A family in the 28 percent bracket with 10 children could see its marginal tax rate climb to 43 percent.
- Contrary to some of the rhetoric, the Democrats' proposal imposes the highest marginal tax rates not on "the rich" but on middle-income families with many children.

TABLE II

New Marginal Tax Rates in 1994

(Family Income: $50,000 to $70,000)

Current Marginal Tax Rate	1 Child	2 Children	4 Children	10 Children
15%	16.5%	18.0%	21.0%	30.0%
28%	29.5%	31.0%	34.0%	43.0%

Higher Tax Bracket for Higher Incomes. To "pay" for their other proposals, the Democrats propose to increase the marginal tax rate by 5 percentage points (from 31 percent to 36 percent) for annual taxable incomes above $115,000 for individuals and $140,000 for couples. Since investment income tends to be a higher proportion of total income for higher-income taxpayers, this proposal penalizes investors and discourages investment. For example, 60 percent of total adjusted gross income over $200,000 in 1989 came from investment income.[22]

The Millionaire Surtax. Perhaps the worst provision of the Democrats' plan is a proposal to place an additional 10 percent surtax on income in excess of $1 million. When combined with a higher tax bracket, this means that incomes over $1 million would be taxed at a rate of almost 40 percent. The proposal is misguided for two reasons.

First, the tax would fall almost totally on investment income, thus discouraging what is most needed — more investment in the American economy. About 75 percent of the income of millionaires is investment income,[23] and income in excess of $1 million is almost all investment income.

"History shows that increases in tax rates on the highest-income group always result in less — not more — revenue for government."

Second, history shows that increases in tax rates on the highest income earners almost always result in less — not more — revenue for government. One reason is that wealthy people have enormous discretion over how they realize their income.[24] For example, instead of investing in real assets, they can buy tax-exempt bonds and pay little or no taxes. Thus the surtax creates the wrong incentives if the objective is more investment and higher economic growth.

The Marriage Penalty. One consequence of the proposal is that it would put a marriage penalty back into the tax code. As noted above, a 36 percent tax bracket would be created for individuals earning more than $115,000 and couples earning more than $140,000. This tax structure creates a very severe marriage penalty. For example, a man and a woman, each earning $115,000, would pay $4,500 more in taxes if they got married.

Comparing the Republican and Democratic Plans

The Bush proposal, even when modified by the House Republicans, is relatively modest — especially when compared to alternatives that might be politically acceptable.[25] Nonetheless, the plan is definitely pro-growth. It is also self-financing. The new investment it would encourage would increase output, national income and, therefore, tax revenues — more than enough to offset the static losses from the tax cuts.

The Democrats' proposal moves in the right direction by creating temporary incentives for increased investment in equipment and restoring the right to make IRA deposits. These pro-growth proposals are offset, however, by higher taxes on investment income realized by higher-income taxpayers. The bill raises tax rates for those most likely to have investment income and lowers tax rates for those least likely to have it. As a result, investment spending would drop each year for the next five years. Investment spending would increase in 1997 and thereafter, however, due to the effects of increased IRA deposits.

"The Democrats' plan would have an immediate negative impact on the economy."

Thus the net effect of the Democrats' plan would be fewer jobs, less output and less revenue for government over the near term. IRA funds build slowly, while the tax increases are immediate. The result is a net loss in economic growth and tax revenue until end of the decade. The so-called tax cut for middle-income families would further increase the federal deficit.

Jobs. As Table III and Figure I show, the Bush plan leads to job creation while the Democrats' plan leads to job losses. Specifically:

- The Bush plan would lead to 479,000 new jobs by 1996 and 612,000 by the end of the decade.
- By contrast, the Democrats' plan would lead to a net loss of jobs — reaching 251,000 lost jobs in 1996.

Note that the Democrats' plan has an immediate negative impact on the economy — which becomes cumulatively worse through 1997. In the final three years of the decade, the negative effects of the plan lessen as the buildup of funds in IRAs begins to offset the higher-income tax rates for higher-income investors.

TABLE III

A Comparison of the Two Plans[1]

(Financial totals are in nominal dollars)

	Jobs (thousands)		Gross Domestic Product ($ billions)		Federal Deficit ($ billions)	
	Bush II	Democrats	Bush II	Democrats	Bush II	Democrats
1992	+ 24	- 83	+$ 12.9	- $ 5.1	+$ 6.6	+ $ 1.5
1993	+ 84	-159	+ 38.0	- 11.8	+ 9.6	+ 4.7
1994	+ 220	-164	+ 67.0	- 14.5	+ 10.1	+ 8.2
1995	+ 353	-219	+ 93.7	- 17.9	+ 8.4	+ 13.0
1996	+ 479	-251	+ 120.8	- 20.1	+ 4.9	+ 18.7
1997	+ 593	-244	+ 143.2	- 18.7	+ 0.7	+ 24.2
1998	+ 609	-255	+ 161.3	- 17.4	- 1.7	+ 30.0
1999	+ 612	-264	+ 179.2	- 16.4	- 2.7	+ 36.1
2000	+ 617	-259	+ 197.0	- 13.9	- 3.5	+ 42.1

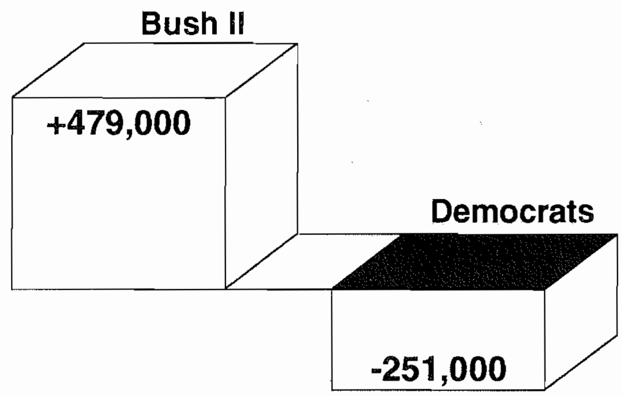
[1] Job totals are the net increase or reduction in jobs as of the year indicated. GDP numbers are annual changes. Federal deficit totals are cumulative as of the date indicated. Bush deficit reduction is the result of dynamic economic growth — changes in pension liabilities were ignored.

"Through 1996, the Republican plan would create 479,000 new jobs, while the Democratic plan would eliminate more than 251,000 jobs."

FIGURE I

Effects on Jobs

(by 1996)



Investment. The biggest difference in the two plans is the effect on investment spending. For the first five to six years, the Republicans reward investors while the Democrats punish them. Specifically:

- The Bush plan would increase investment spending by about $200 billion a year through 1996.
- By contrast, the Democrats' higher taxes on high-income investors would more than offset the stimulus provided by IRA deposits and would decrease investment spending by about $20 billion a year through 1996.
- Cumulatively, the Republican plan would create $1.1 trillion in new investment in the U.S. economy through 1996, while the Democrats' plan would decrease investment spending by $111 billion over the same time period. [See Figure II.]

Output. Because of increased investment under the Bush plan, the nation's annual output of goods and services would grow. By contrast, reduced investment under the Democrats' plan would cause contraction. Specifically:

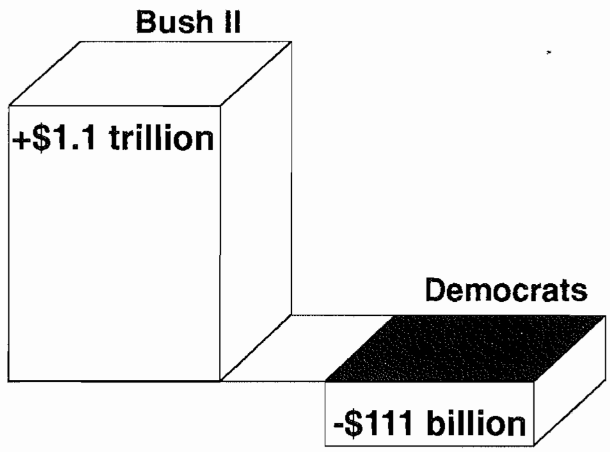
- The Bush plan would increase domestic output by $333 billion through 1997 and by $1.013 trillion by the end of the decade. [See Figure III.]

"Through 1996, the Republican plan would add $1.1 trillion in new investment, while the Democratic plan would decrease investment by $111 billion."

FIGURE II

Effects on Investment

(through 1996)

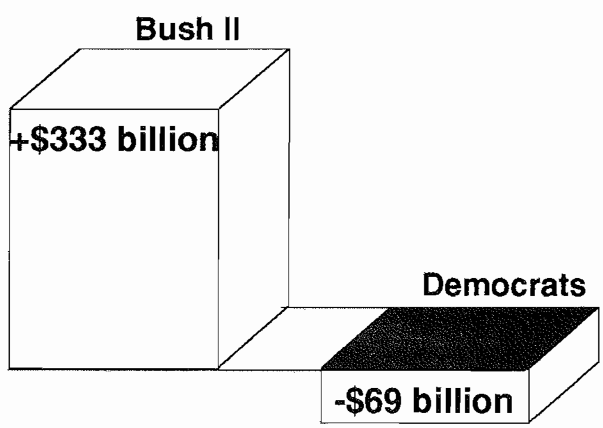


"Through 1996, domestic output would increase by $333 billion under the Republican plan and decrease by $69 billion under the Democrats' plan."

FIGURE III

Effects on Gross Domestic Product

(1992 - 1996)



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- The Democrats' plan would reduce GDP by $69 billion through 1996 and by $136 billion by the end of the decade.

- Thus the difference in the two plans is worth about $4,600 to every man, woman and child in the country.

Federal Deficit. By 1997, the additional revenues caused by greater output would offset the revenue loss from the Bush tax cuts. Thus in the long run the Bush plan is self-financing — even without the accounting gimmicks the Republicans adopted to "pay" for it.

The Democrats' plan, by contrast, would result in a net loss of revenue, adding $19 billion to the federal deficit by 1996 and $42 billion by the end of the decade. [See Figure IV.]

The Fruits of Compromise. Many have argued that the best thing Congress could do for the economy is "nothing," on the theory that prolonged debate and compromise are likely to produce a package that is worse than nothing. Figures V and VI support that view. As the figures show, the Democrats' plan became worse as it was debated — progressing from the House to the Senate to a conference committee compromise proposal.[26]

"Whereas the Republican plan is self-financing, the Democrats' plan would add $42 billion to the federal deficit by the year 2000."

FIGURE IV

Increase in the Federal Deficit

(1992 - 2000)

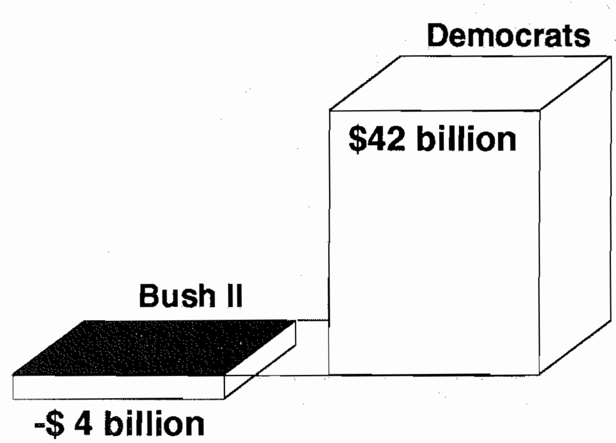


FIGURE V

Number of Jobs

(1992 - 1996)

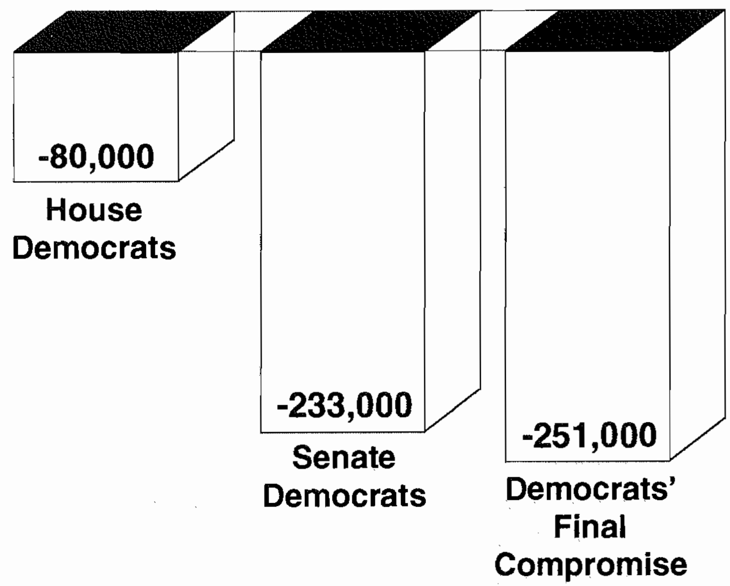
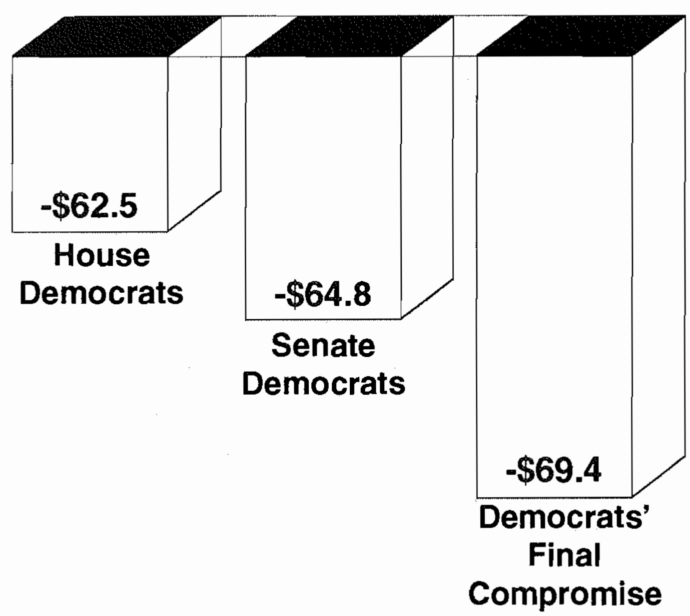


FIGURE VI

Effect on Gross Domestic Product

(1992 - 1996)

"The longer the Democrats' plan was debated, the worse it became."



The Fairness Debate

We calculate that the Bush plan would add $5.7 billion to the aftertax income of investors over the next five years. [See Table IV.] By contrast, the Democrats' plan would lower the aftertax income of investors by $4 billion. Since investors tend to have above-average incomes, does this mean the Republican plan favors the rich?

Almost all arguments about "tax fairness" make the implicit assumption that a tax cut for investors creates no benefit for anyone else. The converse of that assumption is that government could confiscate all of the income of investors with no cost to anyone else. The experience of the U.S. economy says otherwise.

Bush Fairness. Because the Republican plan allows investors to receive an additional $5.7 billion in aftertax income, investors would invest about $1.1 trillion in the economy. (For the most part, investors do not gain unless they make new investments.) This investment would expand the national income by $245 billion, creating $140 billion in new wages for workers and almost $100 billion in new tax revenue for government at all levels. As a result:

- For every $1 in additional income received by investors, workers would receive $25 in additional aftertax wages. [See Figure VII.]
- For every $1 in additional income received by investors, government would receive about $17 in new revenue.

"For every additional dollar investors would get under the Bush plan, national income would grow by $43."

TABLE IV

Total Gains and Losses

1992 - 1996

(Amounts in billions of nominal dollars)

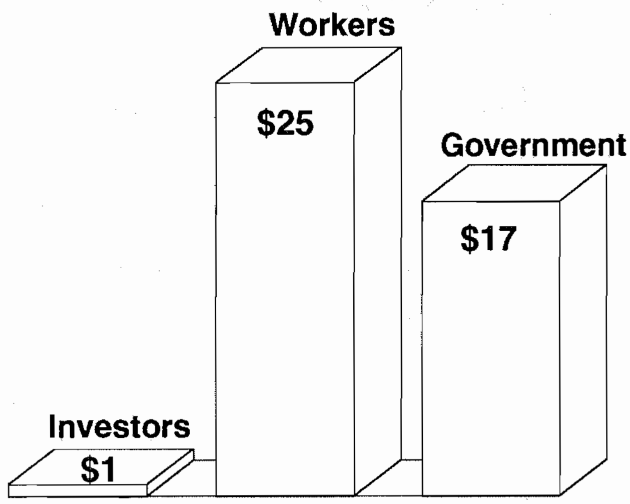
	Bush II	Democrats
Labor Income Net of Tax	+$140.1	- $27.2
Government Revenue	+ 9.0	- 27.6
Capital Income Net of Tax	+ 5.7	- 4.0
Gross Domestic[1] Income	+$244.8	- $58.8

[1]Gross domestic product less depreciation.

"Under the Republican plan, workers would get $25 in additional aftertax wages for every $1 of additional aftertax income for investors."

FIGURE VII

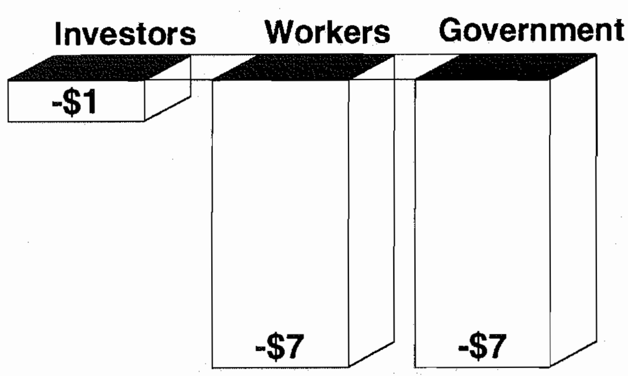
Relative Gains Under The Bush Plan



"Under the Democrats' plan, workers would lose $7 in take-home pay for every $1 reduction in aftertax income for investors."

FIGURE VIII

Relative Losses Under The Democrats' Plan



Democratic Fairness. Because the Democrats' plan reduces the aftertax income of investors by $4 billion, the economy pays a heavy price. Total investment would be reduced by $111 billion, leading to a $69 billion contraction in national output. Moreover:

- For every $1 reduction in the income of investors, workers would lose $7 in wages. [See Figure VIII.]
- For every $1 reduction in the income of investors, government at all levels would lose about $7 in revenue.

"For every additional dollar investors lose under the Democrats' plan, the national income would shrink by $15."

Under the Republican plan, investors would receive 2.3 percent of the increase in national income. Under the Democrats' plan, investors would lose 2.0 percent of the decrease in national income. The "fairness" debate focuses on these almost trivial changes in the fortunes of a few — and ignores the huge impact of the two plans on the rest of us.

Conclusion

Even though the House Bush plan is less stimulative than many had hoped, all of its provisions move us in the right direction. The plan would lead to more investment, more jobs and a higher output of goods and services.

The Democrats' plan combines measures that would stimulate investment with an attempt to redistribute income from high-income to lower-income taxpayers. But since high-income taxpayers derive most of their income from investments, the higher taxes for investors would discourage savings and investment. The net result would be to prolong the current recession and reduce jobs for the foreseeable future.

In general, those left-of-center parties around the world which have won the right to lead their countries have abandoned the politics of redistribution in favor of the economics of growth. They have learned that economic growth is the most effective antipoverty program ever discovered. It is doubtful that the Democratic Party in the United States can regain the presidency unless it too learns this lesson.

Aldona Robbins
Gary Robbins
John Goodman

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Footnotes

[1] See Gary Robbins, Aldona Robbins and John Goodman, "Do We Need a Tax Cut?", National Center for Policy Analysis, NCPA Policy Backgrounder No. 112, January 28, 1992.

[2] See Congressional Budget Office, "Effect of Lower Capital Gains Taxes on Economic Growth," *CBO Papers,* August 1990, and Joint Committee on Taxation, "Explanation of the Methodology Used To Estimate Proposals Affecting the Taxation of Income From Capital Gains," Washington, DC: U.S. Government Printing Office, March 27, 1990. Because of this stance, both agencies ignored the effects of the 80 percent increase in the capital gains tax rate in 1986 and overestimated capital gains income by 50 percent in 1989 and 100 percent in 1990. See Rep. Dick Armey (R-TX), Ranking Republican, Joint Economic Committee, letter to colleagues, February 7, 1992; and Chris Frenze, JEC Republican Staff, memorandum to Republican Members, February 24, 1992.

[3] See the analysis of the Treasury Department's forecast of the effects of a capital gains tax cut in Aldona Robbins and Gary Robbins, "The Bush Savings Plan," National Center for Policy Analysis, NCPA Policy Report No. 152, June 1991.

[4] For an analysis of the effects of payroll tax increases, see Aldona Robbins and Gary Robbins, "Reducing Social Security Taxes: Sound Policy for Today and Tomorrow?", Institute for Policy Innovation, IPI Report No. 110, March 1991.

[5] See Aldona Robbins and Gary Robbins, "Capital, Taxes and Growth," National Center for Policy Analysis, NCPA Policy Report No. 169, January 1992.

[6] Forty-five percent of capital gains income would be excluded from taxation. Thus, given a maximum tax rate of 28 percent, the actual tax would be 15.4 percent (65% x 28%). This rate applies only to assets held for three years, however. The rate would be 19.6 percent for assets held for two years and 23.8 percent for assets held for one year.

[7] Accelerated first-year depreciation would reduce taxable income by an additional 15 percent of investment, but the revenue loss would be made up with lower deductions in later years.

[8] Individuals would have the option either to deposit up to $2,500 per year into a conventional IRA and take a tax deduction or to make the deposit with aftertax dollars to a "flexible IRA" and withdraw the funds tax free after seven years.

[9] A 10 percent tax credit, up to a maximum of $5,000, would be allowed for a home purchased by anyone who had not owned a home in the past three years. This temporary provision would expire on June 30, 1993.

[10] "Passive loss" is the tax term applied to business losses claimed by shareholders who do not actively manage an investment. The Tax Reform Act of 1986 deems all owners of real estate as passive regardless of their involvement in the project. This provision limits the ability of taxpayers to deduct losses against current income from other sources. Losses must be deferred (without adjustment for inflation or the time value of money) until the project generates income sufficient to cover the losses. Real estate projects typically experience initial losses. The passive loss provision has dramatically affected the structure of real estate projects, making them less profitable and lowering their value. The Bush provision would apply to real estate the same passive loss rules applied to other investments. This would allow investors with a direct management role to deduct losses as they are incurred.

[11] A 10 percent luxury tax currently applies to that portion of the sales price of boats above $100,000 and planes above $250,000. This controversial tax, imposed as part of the 1990 budget summit agreement, is alleged to have cost jobs and raised little revenue. See "The Cost of Tax-Related Job Loss versus Projected Revenue Gain from Luxury Taxes in Fiscal 1991," July 1991, and update February 12, 1992, both prepared for Representative Olympia Snow and Senator Connie Mack by Joint Economic Committee Republican Staff.

[12] Other provisions would restore the tax deduction for interest on student loans, make permanent the 20 percent tax credit for investment in research and development, increase from $21 to $60 per month the amount of employer-provided mass-transit benefits a worker can exclude from taxation, allow people who sell their home at a loss to deduct that portion of the loss that exceeds 10 percent of adjusted gross income and temporarily extend special tax benefits to people who invest in low-income housing, bonds that finance low-income housing or hire young, low-income workers.

[13] The alternative minimum tax would be applied to that portion of capital gains excluded from the capital gains tax. See "Treasury's Capital Gains," *Wall Street Journal*, February 6, 1992.

[14] The ability to make deposits would be limited to individuals with incomes up to $60,000 and couples with incomes up to $120,000.

[15] To qualify, the investment must be ordered after February 1, 1992 and before January 1, 1993. It must be put in service before July 1, 1993. For investments within this period, the net effect of this provision is a reduction in taxes equal to 0.8 percent of the value of investment in equipment.

[16] On the sale of real estate, the lower capital gains tax rate would apply only to the portion of the asset that had not been depreciated.

[17] The House Republicans dropped the application of the alternative minimum tax (AMT) to the excluded portion of capital gains income for real estate and corporate stocks. Other assets are still subject to the AMT provision.

[18] See "The Cost of Tax-Related Job Loss."

[19] See Aldona Robbins and Gary Robbins, "Strategy for Growth," National Center for Policy Analysis and the U.S. Chamber of Commerce, NCPA Policy Report No. 170, January 1992.

[20] It also clarifies the status of Pension Benefit Guarantee Corporation claims and the treatment of pension plans in bankruptcy proceedings.

[21] See Aldona Robbins and Gary Robbins, "The Case for IRAs," National Center for Policy Analysis, NCPA Policy Report No. 112, April 1991.

[22] Internal Revenue Service, *SOI Bulletin*, Spring 1991, p. 17.

[23] *SOI Bulletin*, p. 17.

[24] See Lawrence Lindsey, *The Growth Experiment* (New York: Basic Books, 1990).

[25] See Aldona Robbins and Gary Robbins, "Strategy for Growth."

[26] See Aldona Robbins, Gary Robbins and John Goodman, "Federal Budget Issue: Do We Need a Tax Cut?", National Center for Policy Analysis, NCPA Policy Backgrounder No. 112, January 28, 1992; Robbins, Robbins and Goodman, "Federal Budget Issue: Reviving the Economy: Bush vs. The House Democrats," NCPA Policy Backgrounder No. 113, February 28, 1992; NCPA Fact Sheet, "Forecast - Economic and Budget Impact, Senate Finance Committee Tax Bill," National Center for Policy Analysis, March 10, 1992; and NCPA Fact Sheet, "Forecast - Economic and Budget Impact, Conference Committee Tax Bill," March 20, 1992.

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