12. PROMOTING TAX FAIRNESS

The spotlight should shine on those who make the right choice for themselves, their families, and their communities. I have proposed the Middle Class Bill of Rights [to] give needed tax relief and raise incomes in both the short run and the long run in a way that benefits all of us.

President Clinton
January 1995

The budget proposes tax reforms that would promote tax fairness and encourage activities that foster economic growth. It calls for tax cuts that would benefit middle-class families with children, encourage investment in higher education, and promote long-term saving. It helps small business with more favorable treatment of investment, estate tax relief, pension simplification, and health insurance for the self-employed. And it contains targeted tax relief to promote the renewal and environmental cleanup of distressed communities.

The President's tax plan is fiscally responsible. The budget funds the tax relief through cuts in spending and in unnecessary corporate subsidies and other unwarranted tax breaks. In addition, the budget includes a "trigger" mechanism to ensure fiscal discipline by guaranteeing that most of the tax cuts would remain in effect beyond the year 2000 only if the Government is meeting deficit reduction targets.[1]

This chapter provides an overview of the President's tax proposals. For additional details, see Chapter 3 of *Analytical Perspectives*.

[1] The trigger applies to all of the tax relief provisions except pension simplification, estate and gift tax relief, expanded Empowerment Zones and Enterprise Communities, and tax relief for the troops in Bosnia.

Table 12–1. THE PRESIDENT'S TAX PLAN
(In billions of dollars)

	Estimate 1996	1997	1998	1999	2000	2001	2002	Total 1996–2002
Middle Class Bill of Rights tax cuts:								
Provide tax credit for dependent children	–1.1	–9.7	–7.0	–8.9	–10.7	–10.7	–10.6	–58.6
Expand individual retirement accounts	....	–1.4	–0.4	–0.7	–1.1	–1.6	–2.5	–7.7
Provide incentive for education and training	–0.2	–5.8	–5.6	–6.2	–7.5	–7.8	–8.0	–41.2
Subtotal, Middle Class Bill of Rights tax cut	**–1.3**	**–17.0**	**–13.0**	**–15.8**	**–19.3**	**–20.0**	**–21.1**	**–107.5**
Additional targeted tax relief:								
Tax relief for small business:								
Increase expensing for small business	....	–0.6	–0.5	–0.6	–0.7	–0.9	–0.8	–4.1
Provide estate tax relief for small business	....	....	–0.2	–0.2	–0.2	–0.2	–0.2	–1.0
Simplify pension plan rules[1]	*	–*	–0.1	–0.3	–0.3	–0.3	–0.3	–1.4
Increase self-employed health deduction	–*	–0.1	–0.1	–0.2	–0.4	–0.5	–0.5	–1.9
Other targeted tax relief:								
Provide tax incentives for distressed areas	–*	–*	–0.3	–0.6	–0.8	–0.9	–0.8	–3.4
Provide tax relief to troops in Bosnia	–*	–*	....	....	....	....	....	–*
Subtotal, Additional targeted tax relief	**–***	**–0.7**	**–1.2**	**–1.9**	**–2.4**	**–2.8**	**–2.6**	**–11.8**
Restrict corporate loopholes and other proposals	**–0.3**	**5.7**	**7.4**	**9.5**	**10.3**	**10.9**	**12.6**	**56.2**
Modify earned income tax credit[2]	*****	**0.3**	**0.4**	**0.4**	**0.4**	**0.4**	**0.4**	**2.3**

* Less than $50 million.
[1] Net of income offsets.
[2] This proposal reduces outlays by less than $50 million in 1996, and by $0.6 billion in every year from 1997 to 2002.

A Middle Class Tax Cut

The President continues to view tax cuts for middle-income families as an important priority. In 1993, the President worked with the last Congress to enact policies that not only reversed the Nation's trend of steadily rising rising deficits, but also cut taxes for 15 million working families. Building on that progress, the budget proposes to balance the Federal books by the year 2002, but also to ensure that middle-income Americans share the benefits of economic growth.

Specifically, the President again calls for enactment of the Middle Class Bill of Rights that he proposed last year. It would immediately and significantly benefit families with young children, encourage investment in post-secondary education, and promote long-term saving.

The Tax Credit for Dependent Children: Today, most American families with children face significant challenges. Many have two working spouses; others are headed by single parents. All, however, confront their children's economic, educational, and emotional needs.

Economic growth in the last two decades has not generated big gains in after-tax income for most families. In fact, the bottom 60 percent ranked by income lost ground from 1979 to 1992. For more on how Americans at different income levels have fared, see Chapter 2.

The President proposes a non-refundable income tax credit for each dependent child under age 13, a credit that would benefit about 19 million families with 36.6 million dependent children. The credit would be phased in, starting at $300 per child in tax years 1996, 1997, and 1998, and rising to $500 per child in 1999 and beyond. It would be phased out for taxpayers with adjusted gross incomes (AGI) between $60,000 and $75,000. Starting in 2000, the credit and the phase-out range would be indexed for inflation. Working families would first deduct the child credit from their income taxes before deducting the refundable Earned Income Tax Credit—making it easier for them to get the benefit of both credits.

For a two-parent, two-child family with $50,000 of income and $12,500 of itemized deductions, the credit would cut taxes by 25 percent, from $4,005 to $3,005, when fully in place in 1999. Overall, the credit would cut families' taxes by an estimated $58.6 billion from 1996 to 2002.

The Education and Job Training Tax Deduction: Education is vital to making and keeping American workers the world's most productive, but tuition remains a daunting barrier to families of modest means. The President believes that the tax system should better encourage higher education.

The President proposes a deduction of up to $5,000 a year for qualifying education and training expenses in 1996, 1997, and 1998. Beginning in 1999, it rises to $10,000. Qualifying expenses include tuition and fees directly related to a student's enrollment in degree programs and courses to improve job skills. The deduction would be available for the education of a taxpayer, his or her spouse, or dependents.

The deduction would be available whether or not a person itemizes deductions. For taxpayers filing jointly, the deduction would be phased out for returns with modified AGI[2] of $100,000 to $120,000. The phase-out range is $70,000 to $90,000 for other taxpayers. Starting in 2000, these ranges would be indexed for inflation.

Once fully implemented, this tax deduction would cut the taxes of eligible families by up to $2,800. Overall, it would give eligible families $41.2 billion in tax relief from 1996 to 2002, and increase enrollment in higher education and training programs.

Expanded Individual Retirement Accounts (IRAs): The President proposes to expand IRAs in order to provide greater incentives for saving for retirement and other important purposes. Currently, for taxpayers who participate in employer-sponsored retirement plans and file joint returns, the tax code phases out the availability of deductible IRAs between $40,000 and $50,000 of AGI. The President's plan would double this range over time, to $80,000 to $100,000 (and double the range for single taxpayers to between $50,000 and $70,000). The plan also would index for

[2] Modified AGI includes taxable Social Security benefits and certain income earned abroad.

inflation these income limits and the current maximum contribution of $2,000.

Also under this budget, eligible taxpayers could contribute to a "Special IRA" as an alternative to a deductible IRA. Contributions to Special IRAs would not be tax deductible, but distributions of the contributions would be tax-free and—if contributors kept their funds in the account for at least five years—earnings on the contributions would be distributed tax-free as well. Many taxpayers would be eligible to convert existing deductible IRAs to Special IRAs. Also, contributors to both of the IRAs could, at any time, withdraw the funds without penalty to pay for higher education, first-time home purchases, expenses during a period of unemployment, or medical care and nursing home costs.

The expanded eligibility of IRAs would enable many two-earner families to reduce their taxes by as much as $1,120 a year if they make the maximum allowable IRA contributions. From 1996 to 2002, this provision would cut taxes by an estimated $7.7 billion.

Tax Relief for Small Business

Increased Expensing for Small Business: In 1993, the President worked with the last Congress to increase the amount of investment eligible for expensing, which gives needed funds to small businesses that have limited access to capital markets. Expensing also simplifies tax reporting and record-keeping, which are more burdensome for small business. As a result, businesses that invest less than $200,000 a year may deduct $17,500 of investment in the year they place an asset in service, rather than depreciating it over several years. Now, the President proposes to raise this amount to $19,000 in 1996 and continue raising the level so that it reaches $25,000 by the year 2002.

Estate Tax Benefits for Closely-Held Businesses: The budget would cut the burden of estate taxes on farms and other small businesses. It would allow owners of closely-held businesses to defer taxes on $2.5 million of value (up from $1 million under current law), and pay the taxes at a favorable interest rate over 14 years. In addition, the budget would expand the types of businesses eligible for this treatment by making the form of business ownership irrelevant. The budget proposes other changes to cut the administrative burden on taxpayers electing deferral.

Pension Simplification: The President proposes measures to simplify the design and administration of employer-provided pension plans. These measures not only would simplify the tax laws, but would expand pension coverage and stimulate private saving, particularly for employees of small firms.

The President proposes a new plan for small business—the National Employee Savings Trust (NEST). It would replace a series of provisions that limit the contributions of highly-compensated personnel with a simple "safe-harbor" formula, thus removing hurdles that discourage small employers from creating retirement plans for employees. NEST combines the most attractive features of IRA and 401(k) plans, minimizes administrative and compliance costs, and eliminates the need for employer involvement with the Government. NEST is designed to encourage workers of all incomes to save for retirement without complicated forms or calculations.

The budget includes other provisions to simplify pension plans sponsored by businesses of all sizes, as well as tax-exempt employers, multi-employer groups, and the self-employed. These reforms would allow employers to cut administrative costs, and direct more dollars to providing retirement benefits and stimulating retirement savings.

Increased Health Insurance Deduction for the Self-Employed: The Administration has worked hard to expand access to affordable health insurance. One group that faces considerable hurdles is the self-employed. Only 30 percent of their contributions for health insurance are deductible; by contrast, employer-provided insurance is fully exempt from taxes for the employee, and tax deductible for the employer. This budget would increase the deductible share of self-employed health insurance premiums, over time, to 50 percent, benefitting at least three million self-employed people.

Other Targeted Tax Relief

Expanded Empowerment Zones and Enterprise Communities: The President proposes a second round of competition to designate Empowerment Zones and Enterprise Communities, providing over $1 billion in tax benefits through 2002 to these areas. The program promises to mobilize communities to promote business development and create jobs. (For more details, see Chapter 5.)

Brownfields Cleanup: The budget would provide accelerated write-offs of the costs of cleaning up and developing "brownfields"—abandoned, contaminated industrial sites in economically distressed urban and rural areas. (For more details, see Chapter 9.)

Benefits for Troops in Bosnia: The President proposes to extend tax relief that is now available to those in combat operations to U.S. troops involved in the Bosnia peacekeeping operations. While their role is peacekeeping, not combat, the risks and problems of this mission argue for providing a series of benefits, including tax exemptions for certain amounts of pay, the relaxing of filing deadlines, and similar administrative requirements.

Earned Income Tax Credit Targeting and Compliance

The Earned Income Tax Credit (EITC) is a cornerstone of the President's efforts to promote work and self-sufficiency. The budget would maintain the positive work incentives while better targeting the credit and improving compliance. People who are not citizens or not legally authorized to work in this country would no longer be eligible for the EITC.

The budget proposes expedited procedures for handling the failure to provide a correct social security number for the EITC and other tax purposes. It also would restrict eligibility for families with sizable amounts of capital gains and other passive income, and disregard certain losses in computing the EITC phase out. These changes would raise about $2.3 billion from 1996 to 2002.

Loopholes, Corporate Preferences, and Compliance

The budget would reduce or eliminate a series of corporate tax loopholes and preferences that are no longer warranted. Some involve highly specialized financial and accounting techniques. Restricting them would help balance the budget, increase the equity and efficiency of the tax system, and keep corporations focused on productivity and profits, rather than on reducing their taxes.

For example, the plan would:

- Close the loophole that lets individuals accrue gains as Americans and then renounce their citizenship to avoid taxes. The proposal also tightens rules governing foreign trusts with a package of information-reporting and anti-abuse rules directed at sophisticated tax-planning techniques.
- Reform depreciation deductions to better account for expected future income.
- Capture, over time, the indefinite deferrals of income by some large farm corporations.
- Restrict interest deductions for loans taken against corporate-owned life insurance policies, preventing the policies from serving as inappropriate tax-free savings accounts for corporations.
- Require corporations to recognize gains under certain stock sales, rather than treat them as "extraordinary dividends" to avoid corporate taxes.
- Require thrift institutions to account for bad debts in the same way as banks.
- Increase the requirements for corporate tax shelters to register with the Internal Revenue Service (IRS), to help the IRS make more-informed judgments about the merits of the proposed tax treatment.
- Repeal percentage depletion for non-fuel minerals mined on Federal lands that were acquired for nominal amounts under the 1872 Mining Act.

- Deny or defer interest deductions on certain financial instruments that have substantial equity features.
- Restrict interest deductions for corporations that invest in tax-exempt bonds.
- Reform inventory accounting, to reflect costs more accurately.
- Improve compliance by requiring Federal agencies to file information returns for their payments to corporations for services rendered, and by increasing the penalties for not filing correct information.
- Reform the section 936 tax credit (benefiting activities in Puerto Rico and other U.S. possessions), so that it promotes economic activity rather than merely encouraging firms to attribute profits there.

Additional Tax Measures

Finally, the Administration supports revenue-neutral extensions of a range of tax provisions that have recently expired. It also supports revenue-neutral initiatives to promote sensible and equitable administration of the tax laws, including tax simplification initiatives and technical corrections.