US Budget Watch

US Budget Watch is a project created to increase awareness of the important fiscal issues facing the country through and beyond the election. The project seeks to bring attention to the presidential candidates’ tax and spending policies, to help the public become informed about these issues, and to track the new president’s fiscal policies after the election. This guide is not intended to recommend voting for or against any particular candidate, nor does it reflect an assessment of the overall merits of any specific policy proposal.

US Budget Watch is a project of the Committee for a Responsible Federal Budget, which is a non-profit organization committed to educating the public about issues that have a significant fiscal policy impact. The Committee is a bipartisan group of leading budget experts including many of the past chairmen of the House and Senate Budget Committees, directors of the Congressional Budget Office and Office of Management and Budget, and members of the Federal Reserve Board.

This project is supported by the Pew Charitable Trusts. Neither the Committee for a Responsible Federal Budget nor the Pew Charitable Trusts supports or opposes any particular candidate for public office.

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Cover artwork by the Honorable Bill Frenzel
# Summary

<table>
<thead>
<tr>
<th>Barack Obama's Tax Policy Proposals</th>
<th>2013 (Billions)</th>
<th>2009-2018 (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Renew the 2001/2003 Income Tax Cuts for Most Taxpayers</td>
<td>-$111</td>
<td>-$782</td>
</tr>
<tr>
<td>Reform Capital Gains and Dividends Taxes</td>
<td>-$25</td>
<td>-$167</td>
</tr>
<tr>
<td>Reduce the Estate Tax</td>
<td>-$33</td>
<td>-$580</td>
</tr>
<tr>
<td>Renew and Reform the R&amp;E Tax Credit</td>
<td>-$89</td>
<td>-$85</td>
</tr>
<tr>
<td>Patch the Alternative Minimum Tax</td>
<td>-$106</td>
<td>-$1,167</td>
</tr>
<tr>
<td>Extend the Production Tax Credit(^1)</td>
<td>-$5</td>
<td>-$20</td>
</tr>
<tr>
<td>Expand and Reform Current College Tax Credits</td>
<td>-$13</td>
<td>-$120</td>
</tr>
<tr>
<td>Expand the Child and Dependent Care Tax Credit</td>
<td>-$3</td>
<td>-$23</td>
</tr>
<tr>
<td>Create Automatic Workplace Pensions and Expand Savers' Credit</td>
<td>-$21</td>
<td>-$204</td>
</tr>
<tr>
<td>Expand Earned Income Tax Credit</td>
<td>-$5</td>
<td>-$47</td>
</tr>
<tr>
<td>Create a “Making Work Pay” Tax Credit</td>
<td>-$72</td>
<td>-$710</td>
</tr>
<tr>
<td>Create a Universal Refundable Mortgage Credit</td>
<td>-$13</td>
<td>-$126</td>
</tr>
<tr>
<td>Eliminate Income Taxes for Many Seniors</td>
<td>-$7</td>
<td>-$70</td>
</tr>
<tr>
<td>Cut Certain Corporate Taxes</td>
<td>-$13</td>
<td>-$130</td>
</tr>
<tr>
<td>Close Tax Loopholes and Shelters &amp; Unspecified Revenue Raisers</td>
<td>+$77</td>
<td>+$849</td>
</tr>
<tr>
<td>Create Payroll Surtax on High Earners(^2)</td>
<td>+$0</td>
<td>+$0</td>
</tr>
</tbody>
</table>

## Process Changes

| Simplify Tax Filings for Middle Class Taxpayers                         | N/A             | N/A                  |
| Re-instate PAYGO Rules                                                 | N/A             | N/A                  |
| **TOTAL**                                                              | -$359           | -$3,382              |

Note: Some estimates in this report may differ from those in Promises, Promises: A Fiscal Voter Guide to the 2008 Election, because this report calculates everything based on a “current law” baseline, rather than charging the candidates for renewing all of the 2001/2003 tax cuts and then accounting for the expiration of any cuts as new revenue.

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\(^1\) Senator Obama finances the production tax credit through revenue from auctioning carbon permits in his cap-and-trade system and accounts for it as a part of his energy plan, rather than his tax plan.  

\(^2\) Policy would not begin in the 10-year window. More details available in US Budget Watch’s Social Security report at www.USBudgetWatch.org
<table>
<thead>
<tr>
<th>John McCain’s Tax Policy Proposals</th>
<th>2013 (Billions)</th>
<th>2009-2018 (Billions)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Renew the 2001/2003 Income Tax Cuts</td>
<td>-$217</td>
<td>-$1,730</td>
</tr>
<tr>
<td>Reduce the Estate Tax</td>
<td>-$67</td>
<td>-$580</td>
</tr>
<tr>
<td>Renew and Reform the R&amp;E Tax Credit</td>
<td>-$13</td>
<td>-$133</td>
</tr>
<tr>
<td>Reform the Alternative Minimum Tax</td>
<td>-$107</td>
<td>-$1,233</td>
</tr>
<tr>
<td>Double the Personal Exemption for Dependents</td>
<td>-$15 / -$30</td>
<td>-$178</td>
</tr>
<tr>
<td>Reduce the Federal Corporate Income Tax</td>
<td>-$65 / -$78</td>
<td>-$735</td>
</tr>
<tr>
<td>Allow Expensing</td>
<td>+$25 / -$15</td>
<td>-$45</td>
</tr>
<tr>
<td>Close Corporate Loopholes</td>
<td>+$46</td>
<td>+$462</td>
</tr>
<tr>
<td>Ban Internet and Cell Phone Taxes</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Create an Alternative Individual Income Tax System</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>PROCESS CHANGES</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Require 3/5 Majority in Congress to Raise Taxes</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td>Reform PAYGO to Treat Taxes and Spending Equally</td>
<td>N/A</td>
<td>N/A</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td>-$413 to -$481</td>
<td>-$4,172</td>
</tr>
</tbody>
</table>

Note: Some estimates in this report may differ from those in Promises, Promises: A Fiscal Voter Guide to the 2008 Election, because this report calculates everything based on a “current law” baseline, rather than charging the candidates for renewing all of the 2001/2003 tax cuts and then accounting for the expiration of any cuts as new revenue.

3 This policy would not affect any existing federal tax, only prevent new (and primarily state) taxes from being implemented.

4 The McCain campaign says this policy would be revenue neutral. However, other experts do not believe the cost would be zero under an optional system because most taxpayers would choose the system that cost them less, thus raising less for the government. The Tax Policy Center put the cost at $115 billion a year and nearly $1.2 trillion over 10-years. (http://www.taxpolicycenter.org/numbers/displayatab.cfm?DocID=1876&topic2ID=40&topic3ID=&DocTypeID=5). We do not include this estimate because the campaign says that a McCain administration would not implement the policy unless a revenue neutral tax could be designed.
GUIDE TO TAX POLICY:  
THE 2008 PRESIDENTIAL ELECTION

Background

In fiscal 2008, the federal government raised over $2.5 trillion in revenues, or 17.7 percent of GDP. Spending was 20.8 percent of GDP. The result was a federal budget deficit of 3.1 percent of GDP. This budget gap is expected to grow considerably over time.

Chart 1: Revenue as a Share of GDP


The single largest revenue source is the individual income tax. This tax raised almost $1.2 trillion in 2008 through progressive tax rates from 10 percent to 35 percent for earned income, and rates of 0 percent or 15 percent for most long-term capital income. The largest share of this tax is paid by upper-income earners; with the top five percent paying more than half of all income tax. The income tax base is filled with hundreds of “tax expenditures” — exclusions, exemptions and credits — that reward taxpayers for certain activities.

<table>
<thead>
<tr>
<th>LARGEST TAX EXPENDITURES IN 2009</th>
<th>FOREGONE INCOME TAX REVENUE</th>
</tr>
</thead>
<tbody>
<tr>
<td>Employer Healthcare Exclusion</td>
<td>$168 billion</td>
</tr>
<tr>
<td>Mortgage Interest Deduction</td>
<td>$101 billion</td>
</tr>
<tr>
<td>Special Capital Gains Rate on Certain Income</td>
<td>$56 billion</td>
</tr>
<tr>
<td>401(k) Plans</td>
<td>$51 billion</td>
</tr>
<tr>
<td>Charitable Contribution Deduction</td>
<td>$47 billion</td>
</tr>
<tr>
<td>Exclusion of Employer Pensions</td>
<td>$46 billion</td>
</tr>
<tr>
<td>Accelerated Depreciation Rules</td>
<td>$44 billion</td>
</tr>
<tr>
<td>Earned Income Tax Credit*</td>
<td>$41 billion</td>
</tr>
<tr>
<td>Step up Basis of Capital Gains at Death</td>
<td>$37 billion</td>
</tr>
<tr>
<td>State and Local Tax Deduction</td>
<td>$33 billion</td>
</tr>
</tbody>
</table>

*Includes refundable portion of credit, which is treated as spending in the budget


The second largest tax is the payroll tax. This tax, which raised $900 billion in 2008, is used to finance Social Security and part of Medicare. The Social Security portion of the tax applies a 12.4 percent tax on wages up to the first $102,000, half on employees and half on employers. The Medicare tax, which finances hospital insurance, is a 2.9 percent tax on all wages, again split evenly between employer and employee.

The final major source of revenue is the corporate income tax, which raised $305 billion in 2008. The government raises the remaining $173 billion from a variety of sources such as the estate tax, excise taxes, tariffs, and fees.

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Outstanding Tax Issues

The next president will be confronted by a number of outstanding tax issues including the expiration of certain high-profile and politically popular tax cuts and the potential expansion of the Alternative Minimum Tax.

Tax Cuts Expiration

The 2001 Economic Growth and Tax Relief Reconciliation Act (EGTRRA) and the 2003 Jobs and Growth Tax Relief Reconciliation Act (JGTRRA) are set to expire at the end of 2010. These tax laws reduced individual income tax rates, reduced tax rates on dividends and capital gains, expanded the child tax credit, reduced marriage penalties, and phased out the estate tax, among other provisions. Policy makers will have to decide which, if any, provisions to renew, which to allow to expire, and which to modify or reform.

A number of tax expenditures not included in EGTRRA and JGTRRA are also slated to expire including the Research and Experimentation (R&E) tax credit and provisions to promote clean energy, offer corporate tax relief, or meet a variety of other goals. Congress has regularly reauthorized these temporary tax breaks in the past.

Status of Assorted Tax Provisions Before and After Expiration

<table>
<thead>
<tr>
<th>Before Expiration</th>
<th>After Expiration</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Tax Rates</td>
<td></td>
</tr>
<tr>
<td>10%, 15%, 25%, 28%, 33%, 35%</td>
<td>15%, 28%, 31%, 36%, 39.6%</td>
</tr>
<tr>
<td>Estate and Gift Tax</td>
<td></td>
</tr>
<tr>
<td>$3.5 million exemption and top</td>
<td>$1 million exemption and top</td>
</tr>
<tr>
<td>rate of 45% in 2009; no tax in</td>
<td>rate of 55%</td>
</tr>
<tr>
<td>2010</td>
<td></td>
</tr>
<tr>
<td>Child Tax Credit</td>
<td></td>
</tr>
<tr>
<td>$1,000 per child</td>
<td>$500 per child</td>
</tr>
<tr>
<td>Dividends Tax Rates</td>
<td></td>
</tr>
<tr>
<td>0%, 15%</td>
<td>15%, 28%, 31%, 36%, 39.6%</td>
</tr>
<tr>
<td>Capital Gains Tax Rates</td>
<td></td>
</tr>
<tr>
<td>0%, 15%</td>
<td>10%, 20%</td>
</tr>
<tr>
<td>R &amp; E Tax Credit*</td>
<td></td>
</tr>
<tr>
<td>20% tax credit</td>
<td>no tax credit</td>
</tr>
</tbody>
</table>

*The R & E credit is not a part of EGTRRA or JGTRRA, but has substantial costs, and is regularly renewed.


Extending EGTRRA and JGTRRA would cost the government $294 billion in 2013 alone, and $2.4 trillion over the next ten years. Nearly $1 trillion of this would come from renewing the reduced individual income tax rates, with over a third of that being the cost of maintaining the 10 percent bracket that affects the vast majority of taxpayers. 8

The Alternative Minimum Tax

In addition to addressing the expiring tax cuts, the next president and Congress will have to deal with the Alternative Minimum Tax. AMT applies to taxpayers whose tax liabilities are below a preset threshold. The AMT was originally designed to affect only the wealthiest taxpayers, but it was not indexed for inflation and so is applies to an increasing numbers of taxpayers as nominal incomes and the value of deductions and credits rise.

Cost of Indexing AMT under Different Scenarios (Billions)

<table>
<thead>
<tr>
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<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Under Current Law</td>
<td>$76</td>
<td>$76</td>
<td>$70</td>
<td>$39</td>
<td>$46</td>
<td>$54</td>
<td>$64</td>
<td>$74</td>
<td>$86</td>
<td>$99</td>
<td>$685</td>
</tr>
<tr>
<td>Assuming Renewal of 2001 &amp; 2003 Tax Cuts</td>
<td>$76</td>
<td>$76</td>
<td>$87</td>
<td>$100</td>
<td>$114</td>
<td>$130</td>
<td>$147</td>
<td>$164</td>
<td>$183</td>
<td>$203</td>
<td>$1,282</td>
</tr>
</tbody>
</table>


Over the last decade or so, Congress and the White House has prevented the AMT from applying to this much larger group of taxpayers by passing temporary “patches” that roughly adjust it for inflation. This year’s patch, for example, kept over 20 million people off of the AMT rolls. That number is projected to keep increasing in future years.

AMT patches are costly: If the 2001 and 2003 tax cuts are allowed to expire, patching the AMT over the next ten years would mean that the federal government would collect nearly $700 billion less than if the law was not patched. If the cuts are extended beyond 2010, the patch would cost closer to $1.3 trillion. Doing this without offsetting the lost revenue would increase the national debt considerably.

Fiscal Imbalances

The next president will also have to address fiscal imbalances within the government and a dramatically rising federal debt. National debt has been on a more or less steady rise since 1974 when, after a steady decline from the massive debt accumulated during WWII, it hit a low of 33.6 percent of GDP. Total national debt was more than $10 trillion at the start of fiscal year 20099.

This rising debt is driven by entitlement growth, resulting from demographic changes and rapidly rising healthcare costs. An aging population, especially in light of the retirement of the Boomers, is projected to increase Social Security payments from 4.3 percent of GDP

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today to 6 percent in 2030. More significantly, Medicare and Medicaid are expected to grow from just over 4 percent today, to 18.5 percent of GDP by 2082. This level will exceed the average level of federal revenues over the past 50 years.\textsuperscript{10} Even under the most optimistic economic growth assumptions, revenues will not come close to keeping up with this spending growth.

As Chart 3 shows, under reasonable assumptions, non-interest federal spending will climb to 35 percent of GDP by 2082, while revenue will reach 21 percent. This would leave a 14 percent of gap that would have to be made up for with additional borrowing. Interest on this debt is projected to reach 40 percent of GDP, resulting in the government being 75 percent of the economy.\textsuperscript{11}

This crisis may seem to be decades off, but the next president will need to make some choices about how to deal with them in the near term. The longer we wait, the worse these problems become and the more painful the reforms must be to maintain economic stability. At present, the 75-year fiscal gap, which measures the amount that the federal government either would have to cut spending or raise taxes immediately to stabilize the debt-to-GDP ratio over the next 75 years, is 6.9 percent of GDP under realistic assumptions.\textsuperscript{12}

\textbf{Chart 2: Federal Spending as Percent of GDP}

\begin{center}
\includegraphics[width=\textwidth]{chart2.png}
\end{center}


The Congressional Budget Office has said that marginal tax rates would have to rise significantly to cover the entire shortfall using only individual and corporate income taxes. The 10 percent rate would have to rise to 25 percent, the 25 percent bracket to 63 percent, and the 35 percent bracket to 88 percent. Those numbers provide a clear indication both that these problems will need to be addressed in the near future, and that the solution will likely require a compromise that includes both spending and taxing changes.

**Fundamental Reform**

Many analysts and policymakers believe that the tax system also suffers from structural problems that require fundamental reform. Some point to the complexity in the current system, which contains nearly $1 trillion in tax expenditures that often fail to achieve their stated goals. Others point to problems with the corporate income tax, which is among the highest statutory rates in the world.

Many economists believe the current tax code discourages saving and investment and advocate moving toward a consumption tax. Some argue that our tax system should be modified to better encourage or discourage certain types of consumption such as energy, healthcare, or education. Finally, many have distributional concerns over the current tax system, arguing that it either does too much or too little to redistribute income between groups.

But regardless of whether the concern is distribution, complexity, fairness, incentive structures, or economic viability, there is a growing consensus that the current tax system is in need of fixing.

Because of outstanding tax issues, specifically the expiration of the 2001/2003 tax cuts and continued expansion of the AMT, the next president and Congress will have no choice but to address tax policy. As they confront these specific issues, they should also focus on the broader question of how much we want our government to spend, and how we will raise the appropriate revenue to finance that spending.

To make an informed election decision, voters should be aware of the fiscal implications of each candidate’s tax proposals. In the following voter guide, US Budget Watch attempts to shed light on these often-complex policies.

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CAMPAIGN PROPOSALS

Senator Obama

TAX PHILOSOPHY

Senator Obama’s approach to tax policy is motivated in part by a desire to make the system more progressive. Obama believes that, to combat wage stagnation among the middle class, we should maintain and expand tax cuts for most Americans while increasing taxes for those with very high incomes. Senator Obama has pledged not to raise taxes for families making under $250,000 a year.\textsuperscript{14}

ADDRESSING OUTSTANDING TAX ISSUES\textsuperscript{15}

Renew the Expiring Income Tax Cuts for Families Making Under $250,000 a Year \textit{2013 Cost: -$111 billion} \textit{10-year Cost: -$782 billion}\textsuperscript{16}

Senator Obama supports renewing the income tax cuts signed into law by President Bush for families making under $250,000 a year and individuals making under $200,000. Specifically, Obama would: 1) keep the new 10 percent rate for low-income individuals rather than letting it revert to 15 percent; 2) maintain the next three rates at 15 percent, 25 percent, and 28 percent instead of 15 percent, 28 percent, and 31 percent; 3) keep the child credit at $1,000 as opposed to $500; 4) renew the marriage penalty relief provisions that offer married couples a standard deduction and 15 percent tax bracket equal to twice the level offered for single taxpayers; and 5) prevent the Pease and PEP rules, which phase out certain deductions for wealthier taxpayers, from affecting those making less than $250,000.

Senator Obama also assumes the renewal of the remaining income tax cuts for families making over $250,000 and then uses the increased revenue from letting them expire to finance his health care plan. However, because the Congressional Budget Office assumes that these tax cuts will expire as they are slated to by law, they raise no new revenue relative to the official CBO baseline.

\textsuperscript{15} Note: Gross estimates in this report may differ from those in Promises, Promises: A Fiscal Voter Guide to the 2008 Election, because this report calculates everything based on a “current law” baseline, rather than charging the candidates for renewing all of the 2001/2003 tax cuts and then accounting for the expiration of any cuts as new revenue.
Reform Capital Gains and Dividends Taxes  

2013 Cost: $25 billion  
10-year Cost: $167 billion

Senator Obama would maintain the current long-term capital gains and dividends rates of 0 percent and 15 percent for family income under $250,000 a year. For capital gains income of those making over $250,000, Senator Obama would raise the rate to 20 percent, as it would be under current law in 2011. Senator Obama would also tax dividends at 20 percent on income above $250,000 a year rather than allowing them to be taxed as regular income as would occur under current law in 2011. Senator Obama uses a “current policy” baseline in which capital gains and dividends rates would remain at their current level – and from this baseline, his plan would raise roughly $30 billion in 2013 to be used to finance other tax cuts. Under the standard “current law” baseline, however, capital gains and dividends rates would revert to their pre-2003 levels, and so Senator Obama’s plan would cost roughly $25 billion in 2013.

Reduce the Estate Tax  

2013 Cost: $33 billion  
10-year Cost: $580 billion

Under current law, in 2000 the estate tax went from taxing all estates worth over $1 million with a top rate of 55 percent, to in 2009 only taxing estates worth over $3.5 million with a top rate of 45 percent. The tax is set to disappear completely in 2010 and then, because of the expiration of the tax cuts, return to its 2001 levels in 2011. Rather than allow the estate tax to disappear and then reemerge, Senator Obama would permanently keep the estate tax at its 2009 level, with a top rate of 45 percent and a $3.5 million exemption ($7 million for couples). The Obama campaign does not specify whether this would be indexed to inflation, although the current exemption is not. Compared to Senator Obama’s “current policy” baseline, this would raise roughly $44 billion in 2013. Because the estate tax is set to return to its 2001 levels, however, Senator Obama’s plan would cost roughly $33 billion relative to the standard “current law” baseline.

Renew and Reform the R&E Tax Credit  

2013 Cost: $9 billion  
10-year Cost: $85 billion

The Research and Experimentation Tax Credit, frequently referred to as the R&E or R&D credit, provides corporations with a 20 percent tax credit on qualified research expenses above some base amount. This credit has generally been passed as a temporary provision. Senator Obama would renew the credit to encourage technological advancement and make it permanent to create policy stability for firms who invest in multi-year domestic research.

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Patch the Alternative Minimum Tax (AMT)  

2013 Cost: **$106 billion**  
10-year Cost: **$1.167 trillion**  

In the past, Senator Obama has said that he supports “efforts to fix the AMT in a fiscally responsible manner.” But he has not proposed any specifics, nor has he provided potential offsets for any fixes that might occur. Since the Obama campaign assumes the continuation of current policy in their fiscal baseline, we assume the policy of annual patches designed to maintain the number of individuals subject to the AMT will continue.

Extend the Production Tax Credit  

2013 Cost: **$5 billion**  
10-year Cost: **$20 billion**  

Senator Obama would renew the Production Tax Credit (PTC) for five years to encourage the development of renewable energy sources. The PTC provides a 1.9-cent per kilowatt-hour (kWh) tax credit for renewable energy facilities in their first ten years of existence. The credit is adjusted for inflation and applies to wind, solar, geothermal, and closed-loop bioenergy facilities. Other types of renewable energy which are not believed to be quite as clean – such as open-loop biomass, landfill gas, and municipal solid waste – would receive a smaller tax credit. Renewing this credit would be a part of Senator Obama’s $15 billion a year clean energy plan and would be paid for by revenue from auctioning permits in a carbon emissions cap-and-trade system.

EXPANDING CURRENT TAX POLICIES

Expand and Reform Current College Tax Credits  

2013 Cost: **$13 billion**  
10-year Cost: **$120 billion**

Senator Obama would replace the current tax breaks for higher education – the HOPE tax credit, the Lifetime Learning Credit, and the tuition and fees tax deduction – with a new American Opportunity Tax Credit.

Under current law, the HOPE tax credit offers parents 100 percent of the first $1,200 (indexed for inflation) they spend on each child’s post-secondary education and 50 percent of the next $1,200 for a maximum credit of $1,800. The credit is non-refundable, phases out for families making between $94,000 and $184,000.

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22 Estimates modeled by Paul Weinstein, Senior Fellow, the Progressive Policy Institute.


24 A non-refundable tax credit cannot provide relief in excess of a taxpayer’s total tax burden, while a refundable tax credit is not conditioned on taxes paid. For an individual paying $200 in income tax, for example, a $1000 non-refundable tax credit will reduce his tax burden to zero, while a refundable credit would also send him a check for $800.
$114,000 a year (half that for single parents), and can only be used for the first two years of college. The Lifetime Learning Credit is a similar credit that offers up to $2,000 (non-refundable) for tuition. The tuition and fees tax deduction allows those who do not qualify for either credit to deduct $4000 of college expenses from their taxable income.

Senator Obama would consolidate these three benefits into a single tax credit. The American Opportunity Tax Credit would pay for the first $4,000 of college tuition and fees. Unlike current policies, this tax credit would be fully deductable so that those with less than $4,000 in tax liabilities would still qualify. The credit would be calculated based on prior-year tax data so it could be delivered before tuition is due, and it would likely be sent directly the institution where the student is enrolled. We assume the credit would phase-out with higher incomes, as current education tax expenditures do. The credit would be contingent upon a student performing 100 hours of community service.

**Expand the Child and Dependent Care Tax Credit**

**2013 Cost:** $3 billion  
**10-year Cost:** $23 billion

Senator Obama will increase and make refundable the CDCTC. Under current law, workers who need to pay for childcare or dependent care to work can receive a credit worth between 20 percent and 35 percent of the first $3,000 of costs ($6,000 for multiple dependents). In addition to making this credit refundable, Senator Obama would increase the maximum rate from 35 percent to 50 percent, making the credit worth up to $1,500 ($3,000 if multiple children or dependents are being taken care of) rather than $1,050 ($2,100 for multiple dependents). The Tax Policy Center assumes that those making under $30,000 would be eligible for the top 50 percent rate compared to current law where only those making under $15,000 are eligible. The tax credit would decrease by two percentage points for every $2000 of income above $30,000, leveling off at 20 percent for those making more than $58,000 a year. This phase out would be twice as fast as the one provided by current law.

**Create Automatic Workplace Pensions and Expand Savers’ Credit**

**2013 Cost:** $21 billion  
**10-year Cost:** $204 billion

Senator Obama has proposed requiring employers who don’t offer a retirement plan to enroll their employees in an automatic, direct-deposit, tax-deferred Individual Retirement Account (IRA). Employers offering pensions, 401(k)s, or other retirement plans would be unaffected by Senator Obama’s plan. Other businesses would have to establish IRAs for their workers, and deposit a portion of the employee’s salary into the account on a regular basis. The accounts would be “opt-out;” employees would be automatically enrolled unless

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25 Tax Policy Center,  

26 Tax Policy Center,  
they explicitly chose not to have their money deposited into retirement accounts. Enrollees could change the amount deposited, the allocation of their portfolio, or stop depositing money completely at any time.

To reduce the administrative burden on small businesses, Senator Obama has also proposed creating new easy-to-enroll-in savings plans. The accounts would be portable, and savings could be automatically rolled over if a new employer uses a different system. Finally, the IRS would be authorized to deposit tax refunds.

Senator Obama will further reward and promote savings among the poor by expanding the current Saver’s Credit and making it refundable. The Saver’s Credit currently offers a non-refundable tax credit for a worker’s first $1000 of qualified savings, the credit is worth 50 percent for individuals making under $16,000 a year, and phases out so that those making over $26,500 a year are not eligible for a credit.

In addition to making this refundable, Senator Obama would modify the credit to provide a 50 percent match on the first $500 in contributions for all individuals making less than $32,500. The credit would be directly deposited into the individual’s qualified savings account rather than refunded directly to the individuals. It would be phased out so that those making over $37,500 ($75,000 for families) would not be eligible. According to the Obama campaign, if this policy were combined with the Automatic Workplace Pensions plan, over 80 percent of the new spending would go to new savers.

**Expand the Earned Income Tax Credit**

*2013 Cost: $5 billion *
*10-year Cost: $47 billion*  

Senator Obama supports expanding the Earned Income Tax Credit (EITC), which provides a refundable tax credit to low-income workers, especially those who take care of children. The current credit phases in and out, reaching a maximum of around $4,750 for workers with two children, around $2850 for workers with one child, and less than $450 for workers with no children.

Senator Obama would increase the number of working parents eligible for the EITC, increase benefits for parents paying child support, reduce EITC marriage penalties, and ensure that minimum wage workers can receive benefits of up to $555 as opposed to the $175 under current law. According to the Tax Policy Center, Obama would make several changes in calculating the EITC. First, he would increase EITC benefits for childless workers by increasing the income subject to the credit from $5,910 in 2009 to $6,300 in 2009. He would also increase it further to $6,800 in 2010, $7,100 in 2011, and $7,250 in 2012 and by inflation thereafter. He would also increase the phase-out threshold from $7,390 in 2009 to

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$9,825 in 2009, and then to $10,875 in 2010, $12,325 in 2011, and $14,500 in 2012, and by inflation thereafter. Additionally, he would double the benefits paid to childless workers who pay child support, increasing their maximum tax credit from $555 to $1,110. Furthermore, Obama would increase EITC benefits for taxpayers with three or more children. Finally, to reduce so-called marriage penalties, he would increase the phase-out threshold for joint filers to $5,000 higher than for heads of household, rather than the $3,100 under current law.

NEW TAX POLICIES

Create a “Making Work Pay” Tax Credit  

2013 Cost: $72 billion  
10-year Cost: -$710 billion

Senator Obama will provide workers with a refundable tax credit equal to their share of the Social Security payroll tax (6.2 percent of payroll) on the first $8,100 of earnings. For earners with less than that amount in earnings, the “Making Work Pay” tax credit will completely offset the payroll tax. Workers making above $8,100 would receive $500 each, or $1,000 per family. Although the tax is designed to counter the payroll tax, revenue would be drawn from general revenue and not the Social Security trust fund. This credit would be completely refundable against the income tax, and would likely phase out for higher earners; the Tax Policy Center assumed the phase-out would begin at $75,000 ($150,000 per couple) and a phase-out rate of 5 percent.

Create a Universal Mortgage Credit  

2013 Cost: $13 billion  
10-year Cost: -$126 billion

Obama would create a 10 percent universal mortgage interest credit for working homeowners who do not itemize their taxes. This credit would be designed to offer non-itemizers a tax benefit for homeownership akin to that offered to those who do itemize their taxes through the so-called home mortgage interest deduction. The campaign suggests that this credit will offer an average of $500 a year to roughly 10 million homeowners, the majority of whom make less than $50,000 a year. According to the Tax Policy Center, the credit would be capped at $800.

Eliminate Income Taxes for Many Seniors  

2013 Cost: $7 billion  
10-year Cost: -$70 billion

Senator Obama would exempt senior citizens making less than $50,000 a year from taxation. This would mean that Americans over the age of 65 would not need to file any

income taxes if their adjusted gross income, untaxed Social Security benefits, and tax-exempt interest summed to less than $50,000. The policy would phase out with income, although the exact phase-out rate has not been specified. Tax refunds could still be received for eligible seniors exempt from taxation.

Since most seniors making under $50,000 owe little or no taxes under current law, this policy is designed as much to simplify tax filing as to provide tax relief. According to the campaign, 22 million seniors would no longer need to file tax returns.

**Cut Certain Corporate Taxes**

| 2013 Cost: | -$13 billion |
| 10-year Cost: | -$130 billion³² |

Senator Obama supports eliminating capital gains taxation for new businesses, entrepreneurs, and venture capitalists. He has also called for cutting corporate tax rates for corporations that start or expand operations within the United States. So far, his campaign has provided few details on these measures, but Senator Obama has said the offsetting revenue would come from closing corporate loopholes.

**Close Loopholes and Shelters and Unspecified**

| 2013 Revenue: | +$77 billion |
| 10-year Revenue: | +$849 billion³³ |

Senator Obama would reduce tax shelters, close the “tax gap,” reduce corporate loopholes, and eliminate tax breaks for particular industries or special interests. He has identified several potential sources of revenue. First, he has called for taxing carried interest as normal income. Under current law, investment firm partners performing investment management services derive their income from capital investment and so are taxed at the 15 percent capital gains rate. Closing the carried interest loophole would change the rules so that these individuals paid normal income taxes on this income.

Second, he would eliminate tax breaks for gas and oil companies. Although he has not offered specifics, this might include repealing the current rules that allow expensing rather than depreciation of exploration and development costs, eliminating the 15 percent tax credit for enhanced oil recovery costs for tertiary wells, reforming special foreign tax credit rules for oil, eliminating special depreciation rules for assets used for drilling, subjecting interest on oil and gas to passive loss rules, and/or other provisions that prevent oil and gas companies from reaping benefits from the tax code.

Third, Senator Obama would codify the “economic substance doctrine” into law. This doctrine, which is currently in place because of judicial rather than legislative decisions,

³² US Budget Watch estimates based upon candidates’ revenue targets in 2013.
states that transactions made solely for the purpose of receiving a tax benefit, that is, with no “economic substance” to them, are ineligible for any tax benefit.

Senator Obama would also require that publicly traded financial partnerships that argue they are not corporations because the vast majority of their income is “passive” (derived from dividends, interest, or royalties) pay the corporate income tax. He would also close the so-called CEO pay loophole, which allows corporations to deduct stock options paid to executives, even though normal salary above $1 million cannot be deducted.

Additionally, he would create an international tax haven watch list and pressure countries on that list to share information about Americans sheltering income abroad. He would also reallocate many multinational tax deductions. Finally, Senator Obama would require better reporting on capital gains and losses to close the capital gains tax gap. The Obama campaign has also said that it would find other unspecified sources of revenue.

<table>
<thead>
<tr>
<th>Senator Obama’s Plan to Close Tax Loopholes and Shelters (Billions)</th>
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<tbody>
<tr>
<td>Description</td>
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<tr>
<td>Clarify Economic Substance Doctrine</td>
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<td>Reform Overseas Deferral Rules</td>
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<tr>
<td>Repeal Special Expensing Rules for Oil &amp; Gas Companies</td>
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<tr>
<td>Eliminate Foreign Tax Credit for Oil</td>
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<td>Eliminate Deduction for Oil and Gas Firms</td>
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<tr>
<td>Tax Carried Interest as Normal Income</td>
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<td>Close CEO Loophole</td>
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<td>Reallocate Multination Tax Deductions</td>
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<td>Combat Tax Sheltering Through International Tax Havens</td>
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<tr>
<td>Require Better Capital Gains Reporting</td>
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<tr>
<td><strong>Subtotal:</strong></td>
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<tr>
<td>Additional Revenue Raisers</td>
</tr>
<tr>
<td><strong>Total:</strong></td>
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</tbody>
</table>

34 Joint Committee on Taxation, http://www.house.gov/jct/x-3-08.pdf.
43 Estimates vary from less than $1 billion a year to as much as $16 billion a year.
OTHER TAX POLICIES

Create Payroll Surtax on High Earners\textsuperscript{44}  N/A
To bring additional revenue into the Social Security system, Senator Obama supports applying the Social Security tax to the income of workers earning more than $250,000 a year. This would supplement the 12.4 percent payroll tax on earned income up to $102,000. This would take effect in 2018 or later with a rate of between 2 and 4 percent split between employer and employee. Senator Obama has not specified whether unearned income would be subject to the surtax, or whether those who paid the tax would receive corresponding benefits.

Simplify Tax Filings for Middle Class Taxpayers  N/A
Senator Obama supports creating pre-filled tax forms based upon information from banks and employers “so that millions of Americans will be able to do their taxes in less than 5 minutes.” Americans would be sent these pre-filled out tax forms by the IRS and would be asked to verify their accuracy by signing them and sending them back to the IRS or through an equivalent online process. According to the Obama campaign, experts estimate that this would save American taxpayers a total of up to 200 million hours and $2 billion in tax preparation.

Reinstate PAYGO Rules  N/A
Senator Obama supports the pay-as-you-go budgeting rules that require that new spending increases and tax cuts be paid for by offsetting spending cuts or revenue increases. However, he does not believe PAYGO rules should be applied to the expiring tax cuts or the AMT patches.

\textsuperscript{44} Wall Street Journal, http://sec.online.wsj.com/article/SB122488938501868507.html. Because the policy would not take effect for ten years, it would have no cost in 2013 or the 10-year budget window.
Senator McCain

TAX PHILOSOPHY

Senator McCain’s tax policies suggest an overall goal of lower taxes across the board, especially those taxes which hinder economic growth. McCain’s proposals indicate that he would like to reduce the amount of taxes paid by individuals and corporations alike, both relative to current law and current policy levels. Although Senator McCain has declined to take the “tax pledge,” which promises that he will oppose any increase in taxation, he has said that he cannot envision a scenario in which he would increase taxes.45

ADDRESSING OUTSTANDING TAX ISSUES

Renew the 2001 and 2003 Income Tax Cuts

2013 Cost: -$217 billion
10-year Cost: -$1.73 trillion46

Senator McCain supports making permanent all of the income tax cuts enacted in 2001 and 2003 that would otherwise expire in the end of 2010. This means that he would keep the new 10 percent rate for low-income individuals rather than letting it revert to 15 percent. He would maintain the remaining rates at 15 percent, 25 percent, 28 percent, 33 percent, and 35 percent rather than 15 percent, 28 percent, 31 percent, 36 percent, and 39.6 percent. He would also keep the child credit at $1000 as opposed to $500 and renew various provisions for marriage penalty relief that offer married couples a standard deduction and 15 percent tax bracket equal to twice the level offered for single taxpayers. Senator McCain would also continue to tax long-term capital gains and dividends income at rates of 0 percent and 15 percent rather than allowing capital gains to be taxed after 2010 at 10 percent and 20 percent and dividends at the income tax rates.

Reduce the Estate Tax

2013 Cost: -$67 billion
10-year Cost: -$580 billion47

Under current law, the estate tax will disappear completely in 2010. Its phase-out period has already reduced the tax from all estates worth over $1 million with a top rate of 55 percent in 2000, to only taxing estates worth over $3.5 million with a top rate of 45 percent in 2009. The tax is set to disappear completely in 2010, but because of the expiration of the tax cuts, will return to its 2001 levels in 2011.

Senator McCain would keep the estate tax but reduce the rate considerably from current law. Under Senator McCain’s plan, estates worth $5 million or more ($10 million for a

couple) would be subject to a 15 percent tax, which is in line with tax rate on dividends and long-term capital gains. According to the Tax Policy Center, McCain would also make permanent the current deduction for estate taxes paid to states rather than restore the more generous credit that used to apply. They also assume the exemption is held constant in nominal terms as under current law, and that there is no change in the gift tax.

Renew and Reform the R&E Tax Credit

The Research and Experimentation Tax Credit, frequently referred to as the R&E or R&D credit, provides corporations with a 20 percent tax credit on qualified research expenses above some base amount. This credit is generally re-enacted each year as a temporary provision. Senator McCain has proposed replacing this credit, which offers an effective rate of somewhere between 3 and 5 percent, with a permanent R&E tax credit worth 10 percent of all wages spent on research and development.

Reform the Alternative Minimum Tax

Although Senator McCain had originally proposed to permanently repeal the Alternative Minimum Tax (AMT), his campaign now says that he would phase out the tax. Senator McCain would extend and expand the current policy of “patching” the AMT for inflation for five years, and then grow it by 5 percent above inflation every year after that until it hits $143,000, at which point it would be indexed for inflation again. High income taxpayers would still be subject to the AMT under the current tax code, but they would avoid paying it by filing under McCain’s Alternative Simplified Tax (described below).

NEW TAX PROPOSALS

Double the Personal Exemption for Dependents

Currently, taxpayers are exempt from paying income taxes on their first $3,500 of income per taxpayer and dependent family member. John McCain has called for doubling the dependent exemption, although he would allow the personal exemption to remain at $3,500 (indexed for inflation) as under current law.

50 McCain campaign number.
For families making under $50,000, Senator McCain would double the dependent exemption to $7,000 by 2010, and then hold it flat in nominal terms until 2016 at which point it would grow with inflation. For families making over $80,000, the exemption would be increased gradually, growing by roughly $500 a year until it reaches $7,000 in 2016.

Because the exemption is already indexed to inflation under current law and is projected to be $4,200 in 2016, this would represent roughly a 67 percent increase rather than a complete doubling. Families making between $50,000 and $80,000 would receive some type of hybrid. The exemption in 2010 would be reduced $100 for each $1,000 of income above $50,000 until reaching $3,500, and then frozen until it catches up to the normal scheduled increases.

Reduce the Corporate Income Tax

| 2013 Cost: | -$65 billion$52 /-$78 billion$53 |
| 10-year Cost: | -$735 billion$54 |

Corporations currently pay income taxes at rates of 15, 25, 34, and 35 percent with various surcharges at different income levels. Senator McCain has called for eliminating the surtaxes and cutting the top two statutory corporate tax rates down to 25 percent. This policy would be phased in with the top rate reduced to 30 percent in 2010 and 2011, to 28 percent in 2012 and 2013, to 26 percent in 2014, and to 25 percent thereafter.

Allow First-Year Expensing

| 2013 Cost: | +$25 billion$55 /-$15 billion |
| 10-year Cost: | -$45 billion$56 |

Senator McCain would change depreciation rules to allow expensing of equipment. This would mean that instead of allowing the value of equipment to be deducted from taxation a little bit each year, corporations could deduct the full value of the equipment in the first year. Senator McCain would allow such expensing for three-year and five-year business equipment that would otherwise be deducted over 3 or 5 years, respectively. To prevent corporations from tax sheltering, McCain’s proposal would remove the current interest deduction for expensed equipment. These rules would expire after five years unless policy makers chose to renew them.

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53 McCain campaign number.
55 McCain campaign number.
Close Corporate Loopholes

Senator McCain has proposed cutting so-called corporate welfare, that is, the preferential treatment given to certain industries through the tax code. First, he would repeal current LIFO (last in, first out) rules that allow taxable corporate profits for the sale of a particular good to be measured by assuming that the earliest item sold (typically at the lowest nominal price) from inventory is the most recent item purchased by the business (typically at the highest nominal price). As long as prices are rising, this allows corporations to declare less taxable income than they would with FIFO (first in, first out) rules.

Additionally, Senator McCain would repeal the Domestic Production Activities Deduction as part of his corporate tax cut. This deduction reduces the current effective corporate tax rate from 35 to 32 percent for certain activities by domestic manufacturers and would be unnecessary in light of Senator McCain’s plan to reduce statutory rates.

Senator McCain has also said he would eliminate preferential tax treatment of oil companies. In particular, the McCain campaign has said he would repeal rules which allow expensing of exploration and development costs, eliminate the 15 percent tax credit for enhanced oil recovery costs for tertiary wells, and reform special foreign tax credit rules for oil and gas extraction income. Additionally, it would eliminate the current exception to the uniform capitalization rules for intangible drilling costs and eliminate special depreciable lifetimes for assets used in offshore and domestic drilling (five-year depreciable life), exploration assets (seven-year life), refining (10-year life), and pipeline transportation (15-year life,) instead applying regular depreciation lives. Finally, it would subject working interests in oil and gas to the passive loss rules and encourage the Bureau of Land Management to charge market royalty rates instead of the current minimum of 12.5 percent.

Although the McCain campaign has not been specific on exactly where the rest of the revenue would come from, the campaign has said it would first target “rifle-shot tax breaks” which provide benefits to only one or a small number of corporations. His campaign is reportedly looking at tax breaks for life-insurance companies, credit unions and exporters, as well as a low-income housing credit that many believe to be poorly designed.

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57 Tax Policy Center,

### Senator McCain’s Plan to Close Corporate Loopholes (Billions)

<table>
<thead>
<tr>
<th>Description</th>
<th>2013</th>
<th>10-year</th>
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<tbody>
<tr>
<td>Repeal LIFO rules(^{59})</td>
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<td>Repeal Domestic Production Activities Deduction(^{60})</td>
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<td>Repeal special expensing rules for oil/gas companies(^{61})</td>
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<tr>
<td>Eliminate foreign tax credit for oil(^{62})</td>
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<tr>
<td>Disallowing expensing of exploration and development costs(^{63})</td>
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<td>Increase royalty rates for drilling on public land(^{64})</td>
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<tr>
<td>Subject working interests in oil and gas to the passive loss rules(^{65})</td>
<td>*</td>
<td>*</td>
</tr>
<tr>
<td>Eliminate 15 percent tax credit for enhanced oil recovery costs for tertiary wells(^{66})</td>
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<tr>
<td>“Eliminate Low-income housing credit for new projects(^{67})”</td>
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<td>“Eliminate tax breaks for insurance companies(^{68})”</td>
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<td>“Eliminate Deduction for Oil and Gas Firms(^{71})”</td>
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<td><strong>Additional Revenue Raisers</strong></td>
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<tr>
<td><strong>Total(^{72})</strong></td>
<td><strong>$46</strong></td>
<td><strong>$462</strong></td>
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</tbody>
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~The campaign has reportedly considered these policies, but has not yet officially proposed them.
*Less than $500 million
OTHER TAX POLICIES

Ban Internet and Cell Phone Taxes

Senator McCain has said that he will seek a permanent ban on internet taxes, and will also work to prohibit any new taxes on cellular phones. A moratorium currently exists on internet taxes. Cell phone taxes, which vary widely by state, average roughly 15 percent.

Require a 3/5 Majority in Congress to Raise Taxes

John McCain supports requiring that any tax increase be approved by 60 percent of the Congress.

Reform PAYGO to Treat Taxes and Spending Equally

Senator McCain believes that current budget rules have “unfairly stacked the deck to spend more and raise taxes” because they assume the renewal of mandatory spending which expires, but not expiring tax cuts. He has called for instituting pay-as-you-go rules which put the two on equal footing.

Create an Alternative Tax System

Senator McCain has proposed creating a second, simpler tax system, and allowing taxpayers to choose which one they want to use. The alternative system would have only two rates and a generous standard deduction, but few other deductions, exclusions, or credits. While the McCain campaign says this policy would be revenue neutral, other experts do not believe the cost could be zero because under an optional system most taxpayers would choose the system that cost them less. Making a number of design assumptions, including a standard deduction of $10,000, a personal exemption of $40,000, a 15 percent rate up to $50,000 of income, and a 25 percent rate on top of that, and assuming that taxpayers will choose the alternative system if it reduces their current tax liability by at least 10 percent, the Tax Policy Center estimates a cost of $115 billion in 2013 and $1.15 trillion over 10 years.