Presentation to the President's Advisory Panel on Federal Tax Reform

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Overview

- Some History
- Taking Stock
- Why We Are Where We Are

A Modest Beginning . . .

- 1913: 16th Amendment and the Income Tax
  - Less than 1% of population subject to income tax
  - Accomplished solely through $3,000 exclusion ($57,000 in 2004 dollars) for singles and $4,000 exclusion ($76,000 in 2004 dollars) for married couples
  - Rates: From 1% to 7% (on incomes above $500,000) ($9.6 million in 2004 dollars)

From A Modest Beginning . . .

- 1916: the Death Tax
  - From 1% on estates above $50,000 ($870,000 in 2004 dollars) to . . . .
  - 10% on estates above $5,000,000 ($87,000,000 in 2004 dollars)

To Funding a War, . . .

- WW I and its aftermath (1917 – 1924)
  - Significant temporary rate increases (15% → 67% → 77% . . . and back to 25% by 1925)
- A sea change (so to speak):
  - Excise taxes and tariffs fall from 80% of federal revenue in 1914 to about 30% in 1924
- Deductions for home mortgage (and other) interest, charitable contributions, and state and local taxes; capital gains preference; exemptions for children

. . . And Fueling a Depression

- 1929 – 1936
  - Old School: raise taxes in a depression to provide revenue for the government (from 24% top rate in 1929 to 63% by 1932 and 79% by 1936)

FDR and the New Deal: Laying a Foundation

- 1934: Social Security
  - 2% payroll tax on first $3,000 of wages ($42,000 in 2004 dollars)
    - Today: 12.4% on first $90,000 of wages
  - Covered only industrial/commercial workers
    - Today: covers more than 95% of all workers
  - Normal Retirement Age (NRA) of 65 in era where life expectancy was 62
    - Today: NRA heading to 67; life expectancy well over 75
  - Wages and benefits not indexed
    - Today: pre-retirement wages indexed by Average Wage Index (since 1940); post-retirement benefits indexed by CPI (since 1972)
- Payroll tax withholding

The New Deal: From Class Tax to Mass Tax

- 1942 - 1944: From Class Tax to Mass Tax
  - Reduce personal exemptions to the point where percentage of the population subject to income tax increases from about 5% in 1939 to almost 75% by the end of the war
  - Top marginal rates between 88% and 94% on incomes above $200,000 ($2,200,000 in 2004 dollars)
  - Marginal rates of between 78% and 94% in 1944 on incomes between $50,000 and $200,000 ($540,000 to $2,200,000 in 2004 dollars)
    - Only 0.1% of families made over $50,000
- Wage withholding (built on the infrastructure of Social Security payroll tax withholding)

An Accident of History

- WW II Wage and Price Controls
  - IRS issued a ruling providing an exception to taxation of employer-sponsored health insurance in 1920 and had concluded that employer contributions to retirement plans taxed only when retirement income distributed by 1921
  - Following IRS lead, NLRB ignored employer-sponsored health insurance and retirement plans for wage and price control purposes
  - And as a result . . . :
    - Workers covered by employer-provided health insurance increases from 9% in 1940 to 50% in 1950
    - Workers covered by employer pension plans increases from 15% in 1940 to 41% by 1960

After the War: The Government, and the Tax System, Transformed

- Federal Expenditures as a Share of GDP
  - Before WWII: less than 5% of GDP
  - Since WWII: a stable 17-22% of GDP
  - By 2040: entitlements, national defense, homeland security and interest – 28% of GDP
- Federal Tax Revenues as a Share of GDP
  - Before WWII: less than 5% of GDP
  - Since WW II: a stable 17-21% of GDP
  - By 2040: ? ? ? ?
- From Class Tax to Mass Tax
  - Before WWII: about 6% pay income taxes
  - Since WWII: about 70% pay income taxes

Birth of the Modern Era

- The Kennedy Vision
  - Considering the tax law's impact on economic behavior as well as its role in funding government
  - Reduce individual tax rates (top rate from 91% to 70% on incomes over $200,000 ($1.1 million in 2004 dollars))
    - Reduce corporate rates (top rate from 52% to 48%)
    - Investment tax credit
    - Reduce depreciation lives from 19 to 12 years
    - Keogh retirement plans for the self-employed
  - Taxing (some) worldwide income currently

Birth of the Modern Era: A First Run at "Tax Reform"

- The Tax Reform Act of 1969
  - The first legislation dubbed "tax reform" rather than a "revenue act"
  - Backing off JFK's focus on capital investment
    - Repeal of 7% investment tax credit
    - Limit real estate depreciation write-offs
  - Conceiving the AMT: 10% minimum tax on individuals and corporations on certain tax-favored income items above $30,000 ($155,000 in 2004 dollars)
    - Increased tax on capital gains when taxed under the minimum tax

Birth of the Modern Era: The Virtue of Work

- The virtue of work
  - Milton Friedman, President Nixon, the impact of marginal tax rates, and the Earned Income Tax Credit (EITC) (1975)
  - Refundable credits for low-income workers promote and reward work
    - Interaction of welfare and the income tax create confiscatory marginal rates
  - EITC is now the largest federally funded means-tested cash assistance program in the United States
    - The percentage of workers/taxpayers with income tax liability has declined from about 75% - 80% in the early 1980s to about 60% today, thanks to the EITC, child credits, and similar provisions

Birth of the Modern Era: The Virtue of Thrift

- ERISA, Individual Retirement Accounts (IRAs) and 401(k) Plans (1974)
  - In 1975, about 70% of active retirement plan participants were in Defined Benefit Plans
  - By 1998, about 70% of active retirement plan participants were in Defined Contribution Plans

Birth of the Modern Era: Learning from Language

- 1967-68: Treasury Department develops concept of "tax expenditure" and produces first draft of a tax expenditure budget (but not included in the President's budget)
- 1974: Congress passes bill requiring reporting of "tax expenditures"*
- Between 1967 and 1982, tax expenditures as a percentage of income tax receipts increased from approx. 38% to approx. 74%

* Static estimates of tax benefits utilized by taxpayers.

Birth of the Modern Era

- Inflation Feedstock:
  - Between 1961 and 1970, prices increased by 30% and average annual rate of inflation was 2.9%
  - Between 1971 and 1980, prices increased by 103% and average annual rate of inflation was 8.2%
  - Between 1960 and 1981, the average income tax rate for median family of four increases from about 8% to 12%, while the average combined rate (including Social Security and FICA) increases from 10% to more than 18%
- Built-in revenue increases fund the growth of government outlays and periodic tax "cuts"

  1972: Social Security benefits are indexed

The Modern Era: The Reagan Reforms

- Reduction in top individual marginal rates:
  - JFK went from 90% to 70%; Reagan goes from 70% to 50%
- Accelerated Cost Recovery System (ACRS)
  - JFK cut average depreciable life of manufacturing assets from 19 to 12 years; Reagan goes to 15 years for buildings and 3 or 5 years for most forms of equipment
- Curbing inflation feedstock:
  - Individual income tax brackets indexed for inflation in 1981
  - Standard deduction, personal exemption indexed in 1985

Scaling Back: The Primacy of Marginal Rates

- A First Modern Response to Deficits
  - The Reagan Tax Increases: 1982 & 1984
    - Protecting low rates
    - Raising revenue in the capillaries

The Modern Era: A Second Run at Fundamental Tax Reform

- The Tax Reform Act of 1986
- Broaden the base, cut the rates
  - Individuals: top marginal rate reduced to 28%
  - Corporations: top marginal rate reduced to 34%
  - Repealed capital gains preference and eliminated 14 "tax expenditures" (as many tax expenditures as were repealed from 1913 to 1985) and reduced benefits from 72 other provisions
    - *E.g.*, repeal ITC; reduce ACRS benefits; repeal sales tax deduction; deny all personal interest deductions except "qualified residence" interest (capped in 1987)

More From The Tax Reform Act of 1986

- Current version of the individual AMT
  - In 1986, $40,000 threshold for joint filers ($69,000 in 2004 dollars) was not indexed
    - In 1993, threshold raised to $45,000 ($59,000 in 2004 dollars) for joint filers
- Corporate AMT: exacerbating business cycles
- Passive loss rules to deal with tax shelters
  - A lesson learned: transition rules matter
    - 1986 Act contributed to the sudden and significant declines in real estate values

More From The Tax Reform Act of 1986

- Phase-in and phase-out provisions
  - PEP and Pease
  - IRA Limits
  - Beginning of a trend: now substantially all 'incentives' for individuals are capped and phased-out
  - So much for notions of tax neutrality: impact on families with fluctuating incomes and those living in communities with high costs of living
  - Protects marginal rates and "defends against charges of unfairness"
  - Deductions are of little or no benefit to the 40% of taxpayers who don't owe taxes (family of 4 with family income of about $40,000)

The '86 Reform Act: Promises, Promises

- In less than 10 years –
  - Top marginal rates went from 28% to 39.6%
  - Capital gains once again taxed at preferential rates
  - "Tax expenditures" began increasing from a relatively stable 45% (post '86 TRA) to approx. 50% of income tax receipts by 1995 and approx. 65% by 2003
  - Between 1987 and 2004, more than 10,000 amendments were made to the Code

The Modern Era: "Big Picture" Policies Since 1986

- Reducing rates on families and individuals
- Marriage penalty relief
- Refundable child credits
- Expanding the EITC
- Savings and Investment
  - Retirement: Roth IRAs; expanding traditional IRAs and 401(k)s
  - Education: Hope Credits, deductible interest on student loans, 529 Plans, Coverdale accounts
  - Health Care: MSAs
- "Death tax" repeal

The Modern Era:
"Big Picture" Policies Since 1986

- Reducing the double tax on corporate income
- Reducing the rate on capital gains
- Expensing for small businesses
- Energy policy
- International reforms
- Closing loopholes and combating tax shelters

Taking Stock

- A grotesquely complicated system that distorts the allocation of resources and violates common sense notions of fairness
- The Perfect Storm
- The Reasons Why
  - Competing Virtues
  - Primacy of Rates and Budget Constraints
  - The World Around Us

The Perfect Storm

- *S*unsets: Between now and 2011, the following provisions expire – individual, capital gains and dividend rate cuts; small business expensing; the $1,000 child credit and marriage penalty relief; "death tax" repeal

- *A*MT: In 2001 fewer than 2% paid the AMT, by 2010 more than 30% will pay the AMT (including more than 80% of those with family incomes between $100,000 and $200,000)

- *D*eficits: Absent unprecedented spending restraints, the country faces massive and growing deficits

The Perfect Storm (cont'd)

- *E*ntitlements: Inexorable aging of the baby-boomer generation makes it impossible to sustain the course we are on
  - By 2040, Social Security, Medicare and Medicaid alone projected to require 17.3% of GDP
  - 18% is the post-war average of total federal tax revenue as a percentage of GDP

Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.
Source: GAO's Sept. 2004 baseline extended analysis; Bruce Bartlett, Tax Reform Agenda for the 109th Congress 15 (2004).

Reasons Why: Competing Virtues

- Using the income tax to pursue social and economic policies
  - Families, home ownership, education, work, thrift, healthcare, and education; industrial policy (from energy and domestic manufacturing to research and development); respecting federalism
  - The distinction between "promotion" and "removing barriers"
  - Doing it well vs. doing it poorly
  - Interaction of rates and preferences

Reasons Why: The Primacy of Ratesand Budget Constraints

- Budget Rules
  - Gramm/Rudman (1985) and Pay-Go (1990)
  - Budget Reconciliation Rules
- May promote fiscal restraint, but surely promotes bad tax policy
  - Sunsets, gimmicks and legislating in the capillaries
- Exhibit A: The ’86 Act
  - PEP, Pease and Phase-Outs
  - Exempting the AMT from indexing
  - Repeal of the *General Utilities* doctrine without providing for carryover basis regime

Reasons Why: The World Around Us

- Global competition and global capital flows have changed dramatically during the past 20 years – the income tax has failed (and may be unable) to adapt
  - Global Trade
    - Exports rose as a percentage of GDP from 5% in 1962 to 10% in 2004; imports rose from 4% to 15% of GDP
  - Global Markets and Investment
    - U.S. holdings of foreign securities rose from $90 billion in 1984 to $2 trillion in 2000; foreign holdings of U.S. securities increased from $270 billion to $3.5 trillion
    - Between 1980 and 2000, investment flows into the U.S. rose from $560 billion to $7.6 trillion annually while investment flows out of the U.S. increased from $900 billion to $6.2 trillion

Reasons Why: Financial Derivatives

- Financial derivatives have transformed the capital markets during the past 20 years and the income tax has failed to (and likely cannot) keep pace
  - Financial derivatives were de minimis before 1990; by 1998 the notional amount outstanding of global over-the-counter derivatives was $80 trillion; by 2003 that amount had increased to $200 trillion
  - Derivatives make hash of the traditional building blocks of an income tax: notions such as ownership, debt and equity, recognition, and source

Reasons Why: The Role of Intangibles

- Value is moving from "bricks and mortar" to intangibles (patents, technology and highly skilled workers)
  - Intangibles are much more mobile and far harder to define and value
  - They are therefore far more difficult to deal with in the context of an income tax system

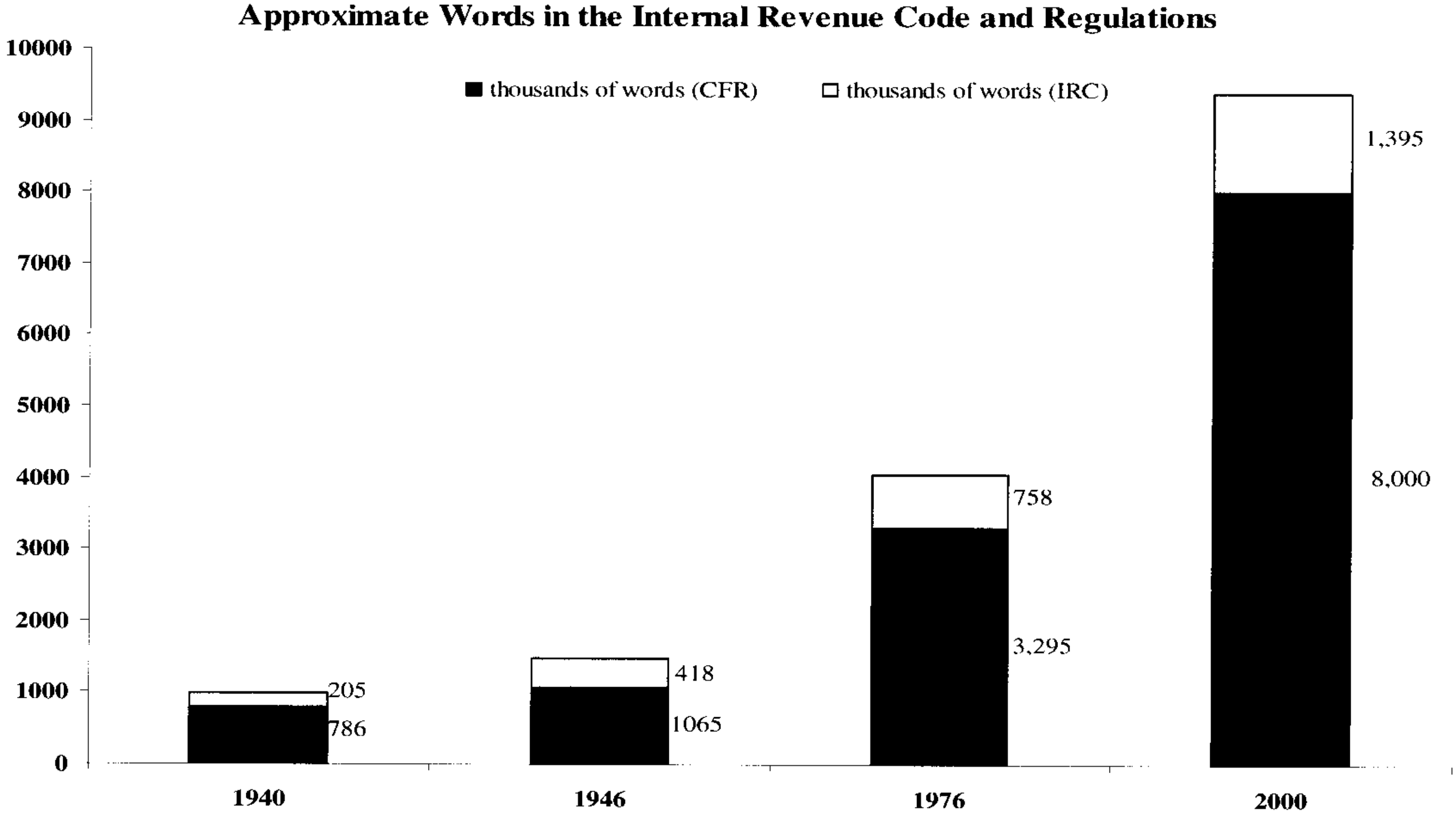
Reasons Why:
Tax Indifferent Parties

- Dramatic growth in "tax indifferent parties" has a significant impact on the income tax system
  - Cross-border capital flows
  - Capital accumulated by pension plans and tax exempt organizations
    - Pension plan assets grew from $450 billion in 1979 to more than $4 trillion dollars by 1998
    - As of 2001, investments held by exempt organizations totaled well more than $1.1 trillion
    - Consider: tax-deductible enterprise debt held by parties not subject to U.S. income taxes

Conclusion

Appendix

The Ever-Growing Complexity of the Income Tax: Growth of the Code and Regulations over Time



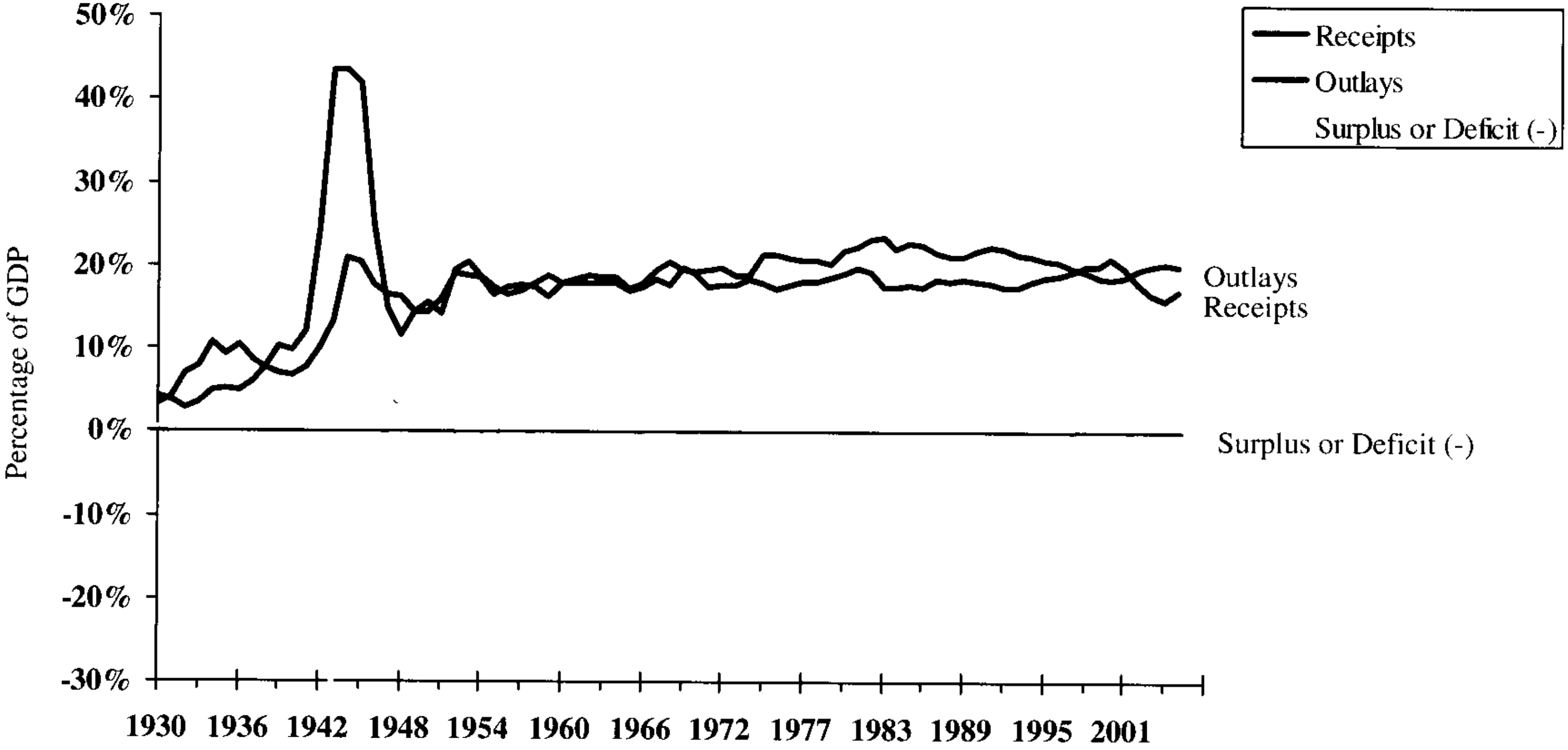
Source: Prof. Michael J. Graetz, Yale Law School. Calculations based on U.S.C. (1940, CCH 1952) and C.F.R. (1940, 1949) and Tax Foundation calculations, based on West's Internal Revenue Code and Federal Tax Regulations (1975), Study of the Overall State of the Federal Tax System, 4 (2001).

The Ever-Growing Complexity of the Income Tax

- The grotesque complexity of the system is self-evident
  - Compliance costs associated with the income tax are conservatively estimated to be 10% of income tax collections, or approximately $115 billion per year
  - Individual taxpayers spend approximately 3 billion hours each year complying with the tax system
  - In 2000, 72 million taxpayers (56%) used paid tax preparers
  - In 2003, the IRS received 89 million calls and had almost 9 million walk-in visits from individuals looking for assistance in completing their returns and understanding the tax code
  - Sunsets
  - Phase-ins and phase-outs
  - 600 different forms, schedules and instructions
  - 1000+ page 2001 Joint Committee on Taxation report on simplifying the federal tax system; 400+ page 2005 JCT report on options to improve compliance and reform tax expenditures

Money in, Money Out – Overview: Federal Receipts and Expenditures over Time

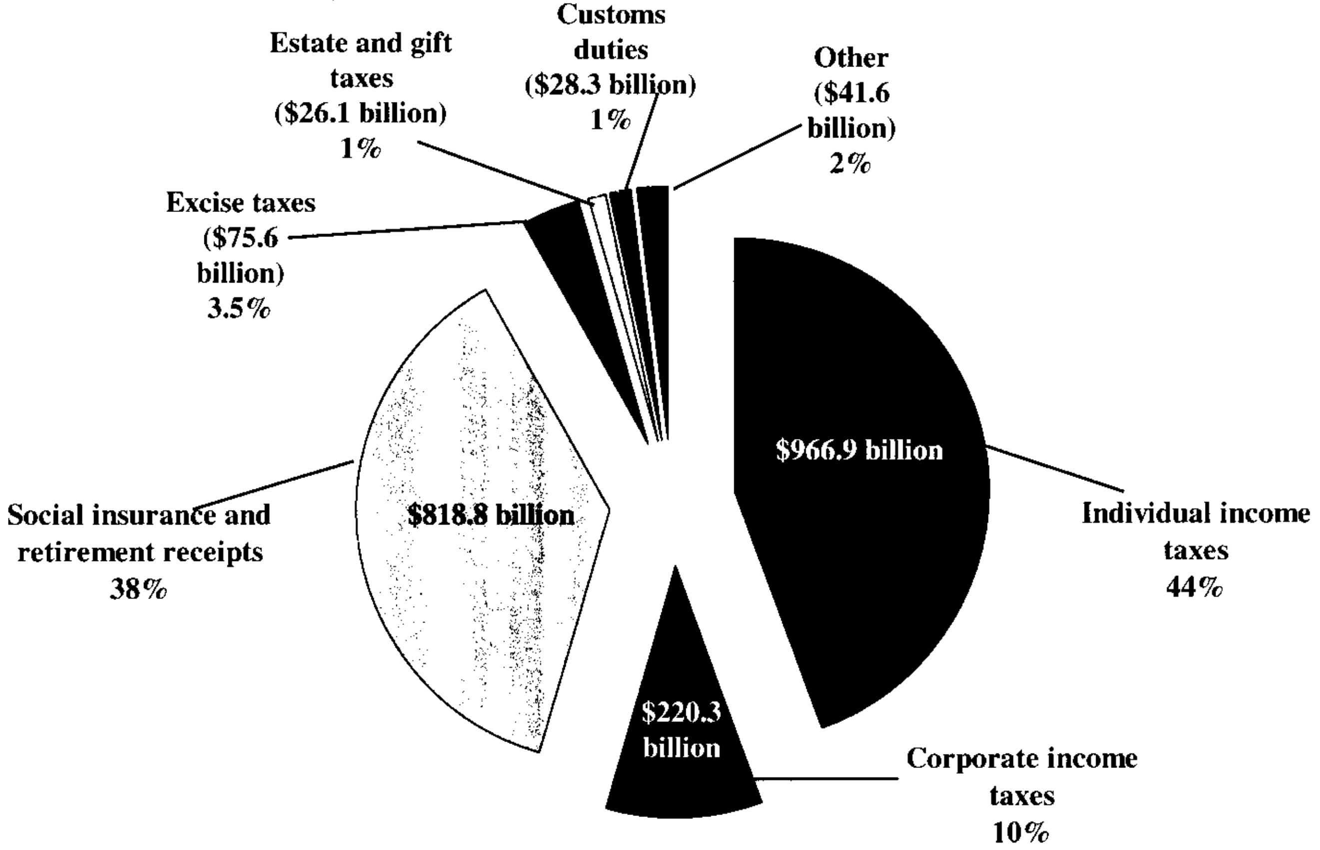
Federal receipts, outlays, and surpluses or deficits as a percent of GDP: 1930-2005



Source: Office of Management and Budget, Budget for Fiscal Year 2006, Historical Tables 23-24 tbl. 1.2.

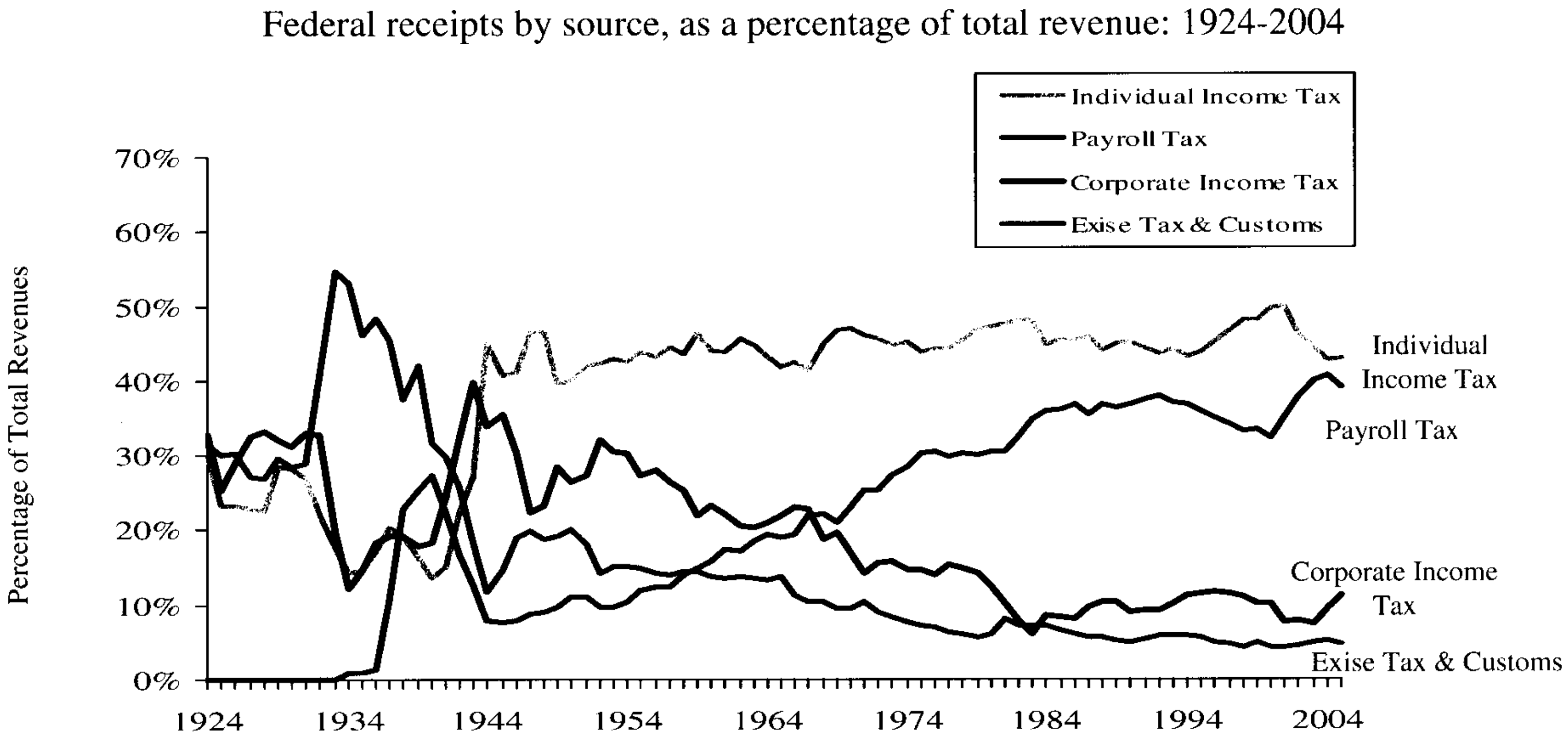
Money In:
Today's Federal Revenues and Their Sources

FY 2006 Budget ($2.18 Trillion in Projected Receipts)



Source: Office of Management and Budget, Budget for Fiscal Year 2006.

Money In: Federal Tax Receipts by Source



Source: Office of Management and Budget, Budget for Fiscal Year 2006, Historical Tables 31-32 tbl. 2.3, 44-45 tbl. 2.5.

After World War II: Rise of the Payroll Tax and Fall of Corporate and Excise Taxes

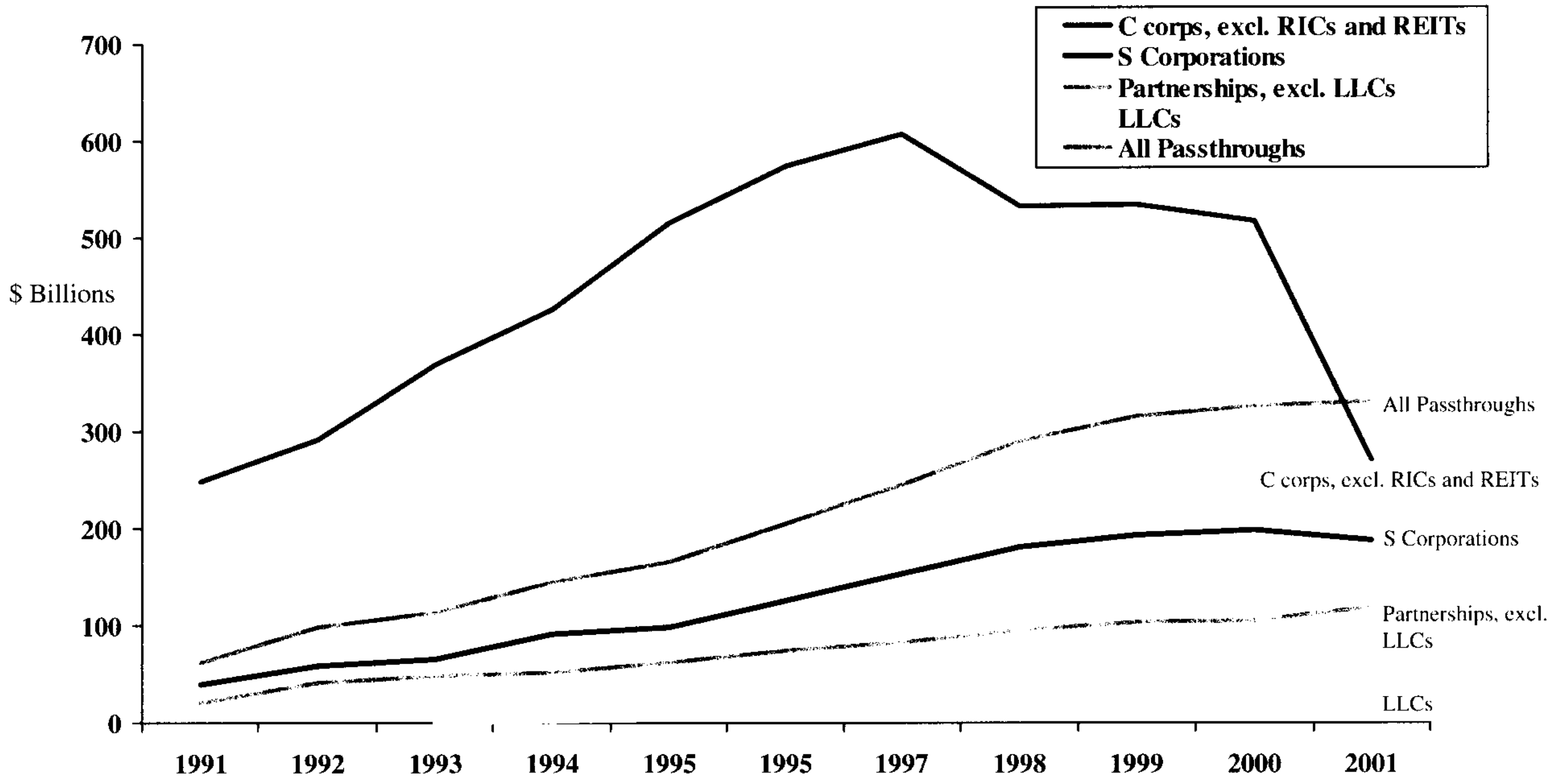
Percentage composition of federal receipts by source: 1940, 1945, 1975, and 2005

	1940	1945	1975	2005
Individual Income	13.6%	40.7%	43.9%	43.5%
Payroll	27.3%	7.6%	30.3%	37.7%
Corporate Income	18.3%	35.4%	14.6%	11.0%
Excise & Customs	31.6%	14.7%	7.2%	4.8%

Source: Office of Management and Budget, Budget for Fiscal Year 2006, Historical Tables 31-32 tbl. 2.2, 44-45 tbl. 2.5.

Money In: Business Net Income by Type of Legal Entity over Time

Business net income reported by various types of legal entities, 1991-2001

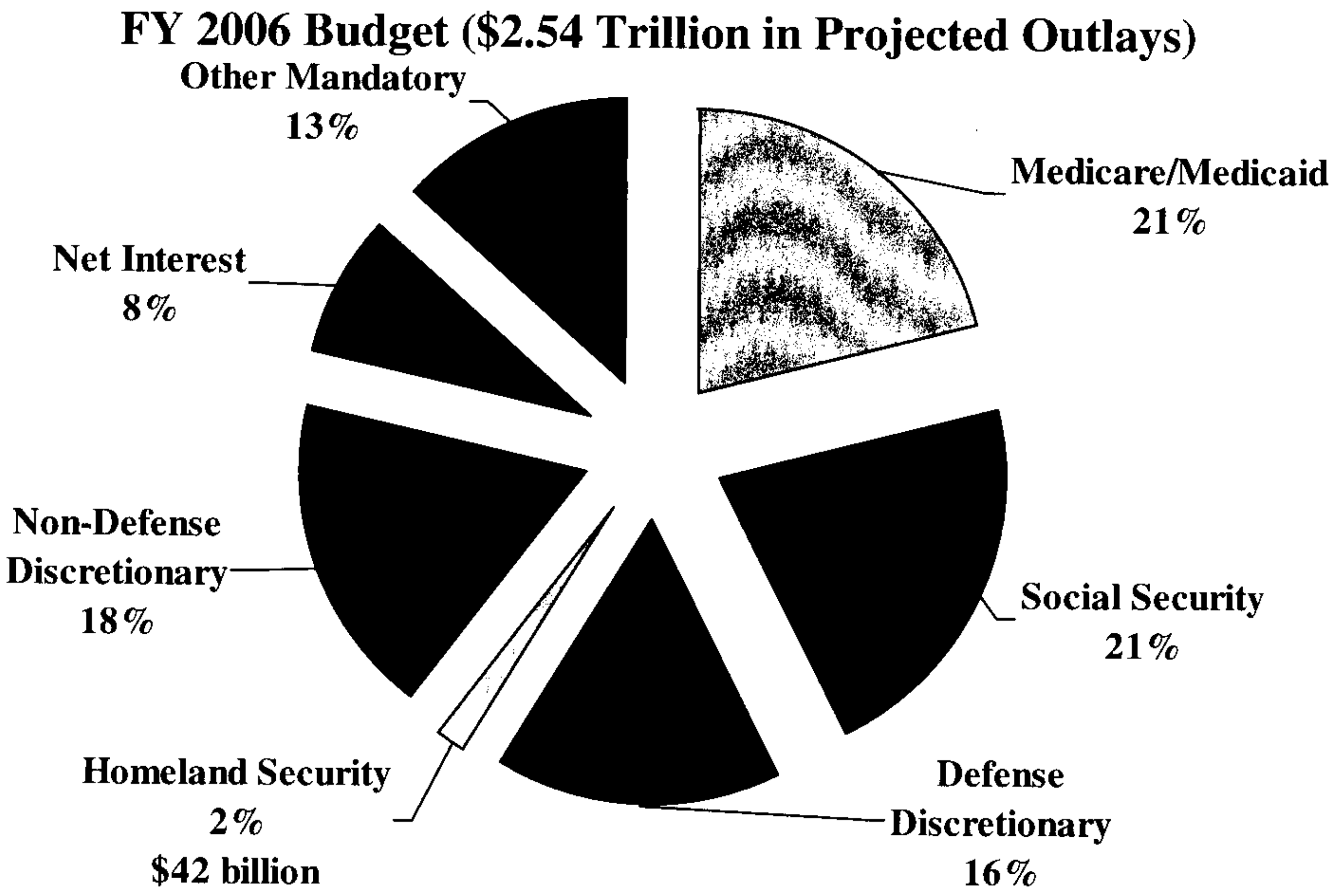


Source: Drew Lyon, PricewaterhouseCoopers, presented at the 6th Annual Tax Council Policy Institute Symposium, Feb. 11, 2005. Underlying data from IRS Statistics of Income.

Money In: Business Net Income by Type of Legal Entity over Time

- "C" corporation tax receipts as a percentage of federal tax revenues have fallen substantially from their post-WWII highs
- However, since 1990, the share of GDP contributed by corporate tax receipts has been relatively constant
- Business net income earned through "pass-through" entities has grown significantly since 1990
  - Unlike tax revenues generated from "C" corporation income, tax revenues generated from pass-through entity business income are accounted for as individual income tax revenues
  - In 1990, "C" corporation net income represented approximately 85% of business net income; by 2000 "C" corporations earned only approximately 60% of business net income
- Looking at "C" corporation tax receipts alone masks the "dis-incorporation" trend; share of federal tax revenues from business income may actually be increasing over time

Money Out: Today's Federal Government - An Insurance Company with an Army

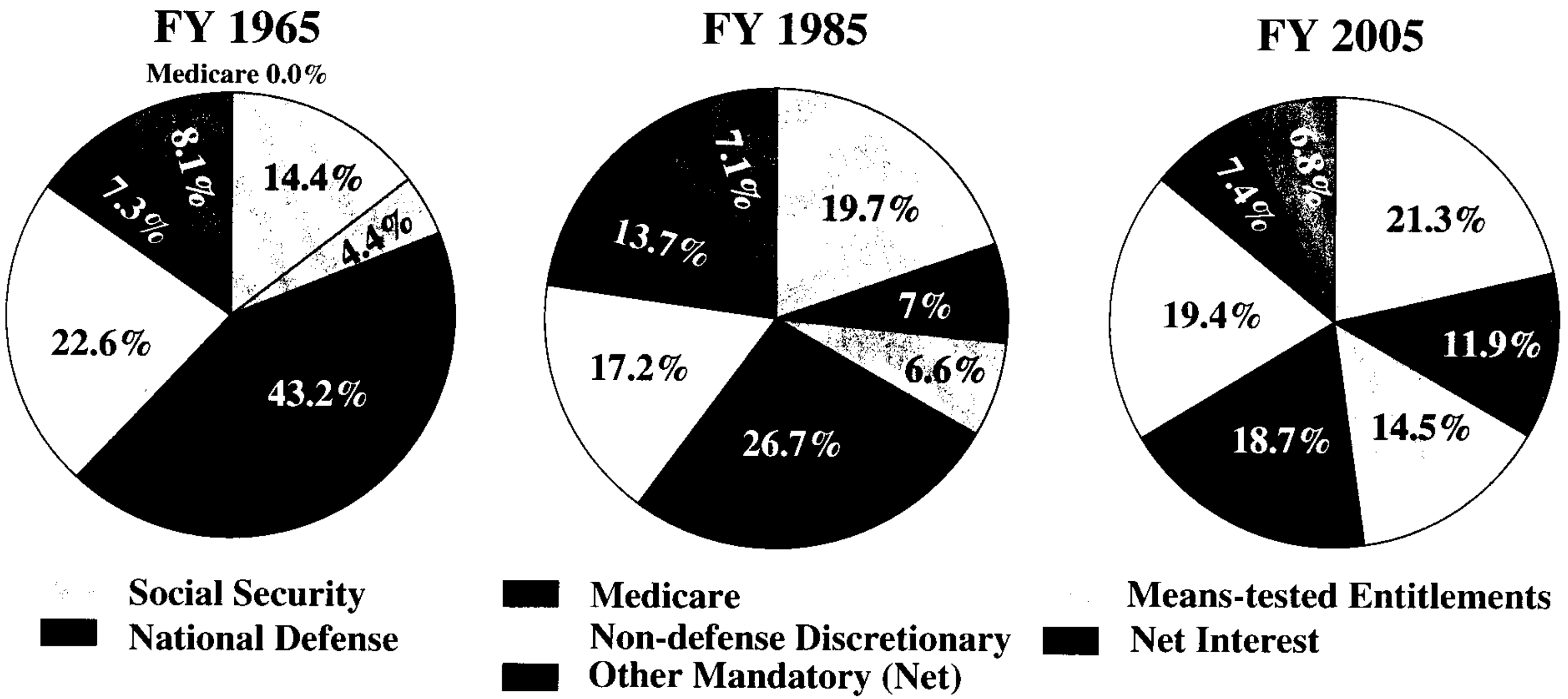


Note: "Other mandatory" includes various education and training programs, federal employee retirement and disability, unemployment compensation, food and nutrition assistance, supplemental security income, the earned income tax credit, payments to states for foster care/adoption assistance, housing assistance, and other federal programs. Medicare/Medicaid outlays include federal spending on the state children's health insurance fund.

Source: Office of Management and Budget, Budget for Fiscal Year 2006.

Money Out: Federal Expenditures by Category over Time

Percentage composition of federal outlays by category of expenditure: 1965, 1985, and projected 2005

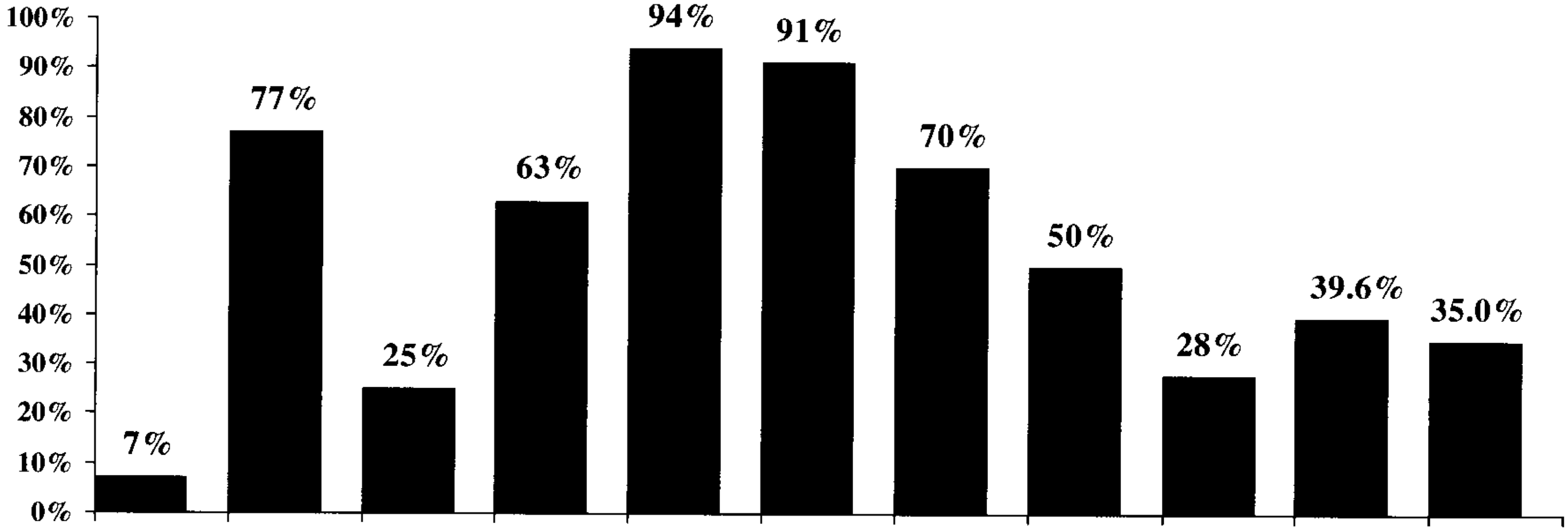


Note: Means-tested Entitlements include Medicaid, food stamps, earned income tax credits (EITC and HITC), family support assistance (AFDC), temporary assistance to needy families (TANF), welfare contingency fund, supplemental security income, state children's health insurance, and veterans pensions.

Source: Office of Management and Budget, Budget for Fiscal Year 2005, Historical Tables,127 tbl. 8.3, 50-52 tbl. 3.1.

Top Marginal Individual Income Tax Rates for Selected Periods

Top U.S. marginal individual income tax rates and top bracket thresholds in selected years between 1913 and 2003



	1913-15	1918	1925-31	1932-35	1944-45	1954-63	1965-67, 1971-80	1982-86	1988-90	1993-00	2004
Threshold ($ thousands, constant 2004 dollars)	$9,400	$12,500	$1,100	$14,500	$2,100	$2,800-$2,400	$1,200, $930-$490	$300-$170	$47	$325	$320

Note: The top marginal rate in 1929 was 24%. For 1988-1990, some taxpayers faced a 33% marginal tax rate in an income bracket below the one cited for the 28% rate. However, the marginal rate returned to 28% above this 33% bracket, so that for all sufficiently high incomes, 28% was the marginal rate. Range in top bracket threshold for 1954-63, 1965-1967, and 1971-78 due principally to inflation. Range in top bracket threshold for 1982-1986 due principally to legislative changes in top bracket threshold.

Source: IRS, Statistics of Income Bulletin app. A (Winter 2002-2003).

Tax Expenditures FY 2006

The 6 largest tax expenditures for FY 2006 are:

Employer health care/insurance exclusions*		$130.2 billion
Tax-preferred retirement savings**		$117.7 billion
Mortgage interest deduction		$76 billion
State and local tax deduction:		
Income	$34.6 billion	
Property	$14.8 billion	
Total		$49.4 billion
Charitable deduction		$39.9 billion
Earned income tax credit***		$39.5 billion

* Includes deductibility of self-employed medical insurance premiums ($4.3 billion) and tax credit for health expenditures purchased by certain displaced and retired individuals ($140 million, including $100 million in outlays). Does not include Medical Savings Accounts and Health Savings Accounts ($1.8 billion) or deductibility of medical expenses ($9.1 billion).

** Includes employer-provided pension contributions and earnings, 401(k) plans, IRAs, low and moderate income savers' credit and Keogh plans.

*** This number includes both outlays ($34.1 billion) and tax expenditures ($5.4 billion).

Source: OMB, Budget of the United States Government FY 2006, Analytical Perspectives 319, 324.

Tax Expenditures FY 2006

The next 8 largest tax expenditures for FY 2006 (cont.):

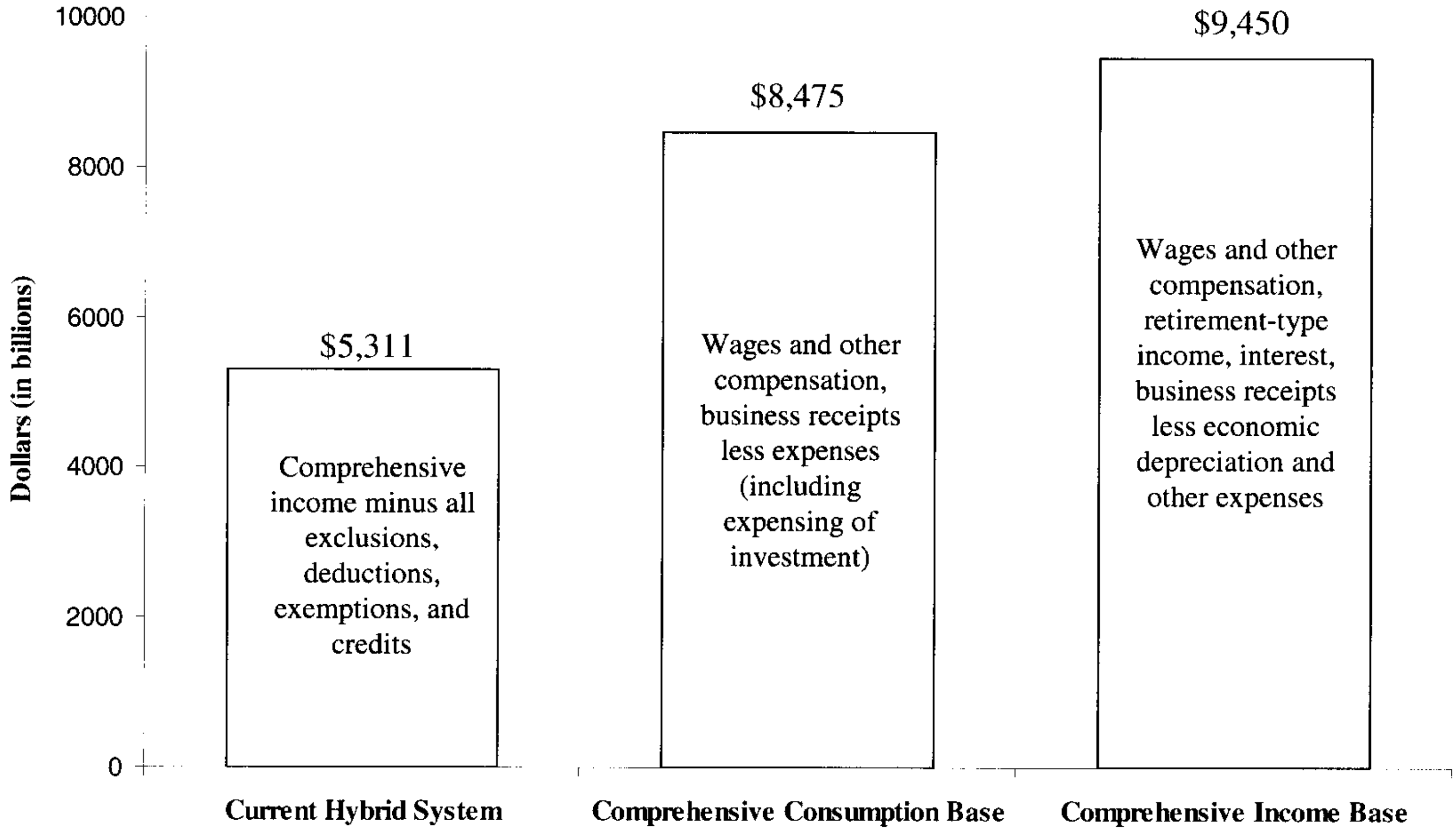
Exclusion of capital gains on homes	$36.3 billion
Child credit	$32.8 billion
Exclusion of net imputed rental income on owner-occupied homes	$29.7 billion
Reduced rates on capital gains	$29.3 billion
Step-up basis of capital gains at death	$28.8 billion
Partial exclusion for Social Security benefits	$27.6 billion
Exclusion of interest on state/local bonds	$26.6 billion
Exclusion of interest on life insurance savings	$24.1 billion

Compare projected individual income tax receipts for 2006: $966.9 billion

Note: "Exclusion of interest on life insurance savings" includes deferral of tax on inside build-up of annuities.

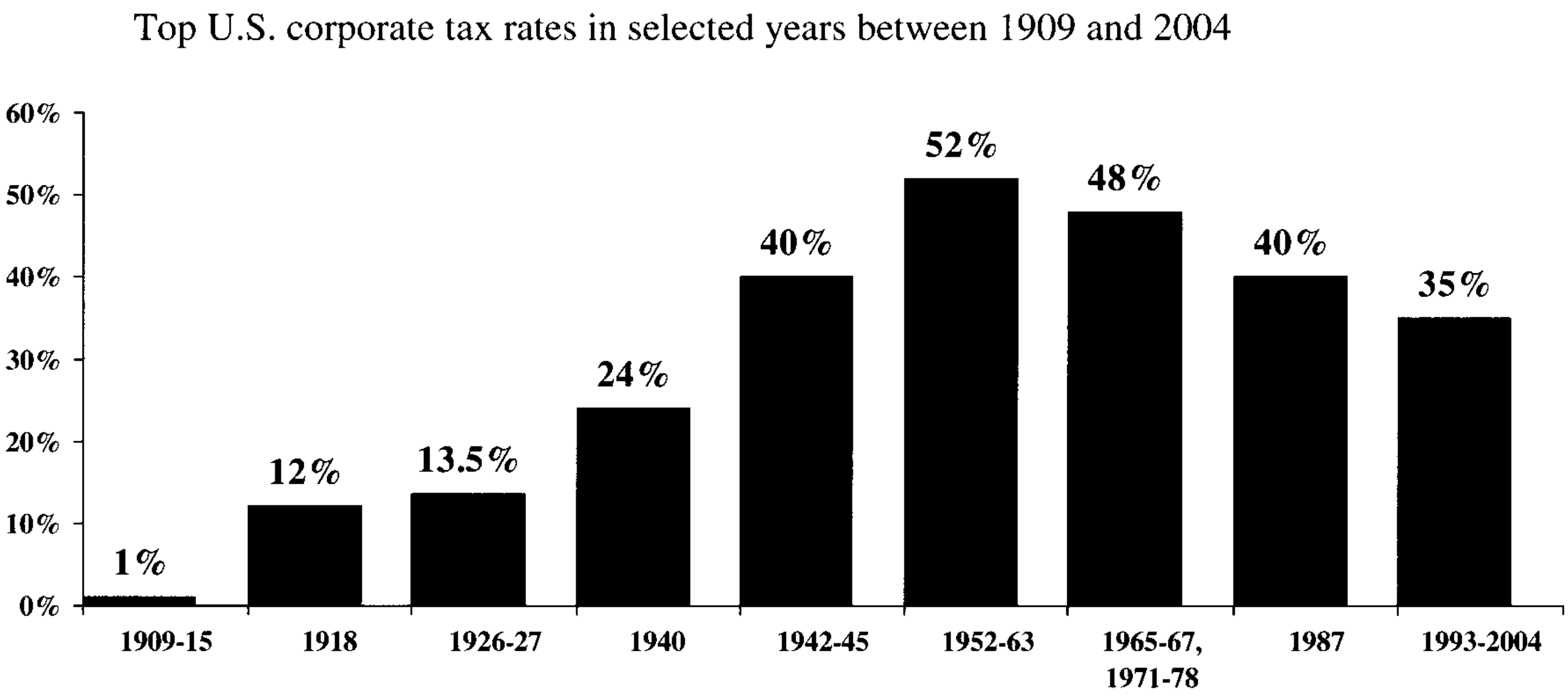
Source: OMB, Budget of the United States Government FY 2006, Analytical Perspectives 319, 324.

Alternative Tax Bases (2000)



Source: Council of Economic Advisors, Economic Report of the President 191, Chart 5-4 (2003)

Top Marginal Corporate Income Tax Rates for Selected Periods



Note: In 1940, 1942-45, 1987, and 1993-2002, some corporate taxpayers in income ranges below the highest bracket faced a higher tax rate than the rates represented above.
Source: IRS, Statistics of Income Bulletin 287-90 tbl. 1 (Fall 2003).

Highest Rates of Income Tax: U.S. and Selected Trading Partners

Personal Income Tax Rates

Country	Rate	Threshold in $ (using PPP*)
Germany	51.2%	$ 59,214
Japan	47.1%	$ 159,730
Canada	46.4%	$ 85,991
Italy	46.1%	$ 93,769
United States	41.4%	$ 319,749
United Kingdom	40.0%	$ 55,081
France	37.9%	$ 85,779

*Purchasing Power Parity

Corporate Income Tax Rates

Country	Rate
Japan	40.9%
Germany	40.2%
United States	39.4%
Canada	36.6%
France	35.4%
Italy	34.0%
United Kingdom	30.0%

Note: 2003 data. All rates include the rates of sub-central governments. The individual income threshold is the amount of earnings at which the reported combined top marginal rate is first observed. Germany's corporate income tax rates include the regional trade tax and the surcharge while Italy's rates do not include the regional business tax. Since 2003, Germany has moved to lower its corporate tax rate. Ireland's corporate tax rate in 2003 was 12.5%.
Source: OECD Tax Database, tbls. I4, I5.

Effective Marginal Corporate Income Tax Rates: U.S. and Selected Trading Partners

Effective Marginal Corporate Income Tax Rate

Country	Standard Rate
Germany	28.0%
United States	**24.0%**
France	21.0%
EU Average	20.4%
United Kingdom	20.0%
Italy	9.0%

Effective marginal corporate tax rate in the manufacturing sector. Assumes that the tax is on return from investment in plant and machinery and is financed by equity or retained earnings. State-level corporate tax rates, as well as supplementary taxes (i.e., corporate surcharges) are included. Taxation at the shareholder level is not included.

Note: 2001 data.
Source: Eric Engen and Kevin A. Hassett, "Does the U.S. Corporate Tax Have a Future?," Tax Notes, 30th Anniversary Issue, 24 tbl. 2. (2002).

Standard VAT/GST Rates for U.S. Trading Partners

VAT/GST Tax

Country	Standard Rate
Italy	20.0%
France	19.6%
United Kingdom	17.5%
Germany	16.0%
Canada	7.0%
Japan	5.0%
United States*	**0.0%**

A Value Added Tax (VAT)/Goods and Services Tax (GST) is a tax on all business sales less purchases from other businesses.

* Although the United States does not impose a VAT, retail sales taxes, another form of consumption tax, are collected by most U.S. states and localities.

Note: 2003 data.
Source: OECD Tax Database, tbl. I.7.

What's Their Share: Distribution of the U.S. Federal Income Tax Burden

Distribution of the U.S. federal income tax burden in selected years

	1954	1975	1990	2002
Top 1%	25.1%	18.7%	14%	33.7%
Top 5%	40.0%	36.4%	27.6%	53.8%
Top 10%	51.0%	48.5%	38.8%	65.7%
Top 25%	70.9%	71.7%	62.1%	83.9%

Source: IRS, Statistics of Income Division, Table 1: Individual Income Tax Returns with Positive Adjusted Gross Income (AGI): Number of Returns, Shares of AGI and Total Income Tax, and Average Tax Rates, by Selected Ascending Cumulative Percentiles of Returns Based on Income Size Using the Definition of AGI for Each Year, Tax Years 1986-2002 (Sept. 2004), unpublished SOI data available at http://www.irs.gov/pub/irs-soi/02in01ts.xls; Gary Robbins & Aldona Robbins, Institute for Policy Innovation, Looking Back to Move Forward: What Tax Policy Costs Americans and the Economy 18 tbl. 21, IPI Policy Report # 127 (1994).

What's Their Share: Married Couples at the Poverty Level

Share of wages paid by married couples at the poverty level
in federal individual income taxes for selected years

	Number of children		
	0	1	2
1970	5.9	4.2	3.7
1980	0.3	-5.9	-0.9
1985	2.4	-0.8	3.2
1990	0.0	-9.1	-5.3
1995	0.0	-15.8	-14.7
2000	0.0	-15.6	-16.5
2001	0.0	-18.3	-21.0
2002	-0.1	-19.5	-23.2

Source: Deborah I. Kobes & Elaine M. Maag, *Tax Burden on Poor Families Has Declined Over Time*, 98 Tax Notes 749 (2003).

Upcoming Rate Changes, Sunrises, and Sunsets of Selected Taxes

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Individual Income Tax Rates	Rates reduced to 35, 33, 28 and 25%								Rates revert back to 39.6, 36, 31 & 28%
Capital Gains	Tax rate reduced to 5/15%					0/15%	[illegible]		
Dividends	Tax rate reduced to 5/15%					0/15%	[illegible]		
Estate Taxes	Top rate falls to [illegible]	[illegible]	Top rate falls to 47%		Top rate falls to 45%		Exempt amount up to $3.5mil	Estate tax repealed	Reverts back to 55%; exempt amount back to $1mil
	2003	2004	2005	2006	2007	2008	2009	2010	2011

Further Selected Upcoming Changes to Individual Income Tax Rules

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Alternative Minimum Tax	AMT exemption amount increased to $40.25K / $58K for single/joint			AMT exemption amount reverts back to $33.75K / $45K					
Standard Deduction for Joint Filers	Up to 200% of standard deduction for single filer								Reverts back to 167% of single filer
10% Bracket	Bracket upper level up to $7K / $14K for single/joint filers, subject to annual increases to reflect cost of living adjustment								Bracket eliminated; lowest bracket 15%
15% Bracket for Joint Filers	Top of bracket up to 200% of top of single filer bracket ("single filer")								Top of bracket reverts back to 167% of top of single filer bracket
Child Credit	Up to $1,000 per child								Back to $500 per child
	2003	2004	2005	2006	2007	2008	2009	2010	2011

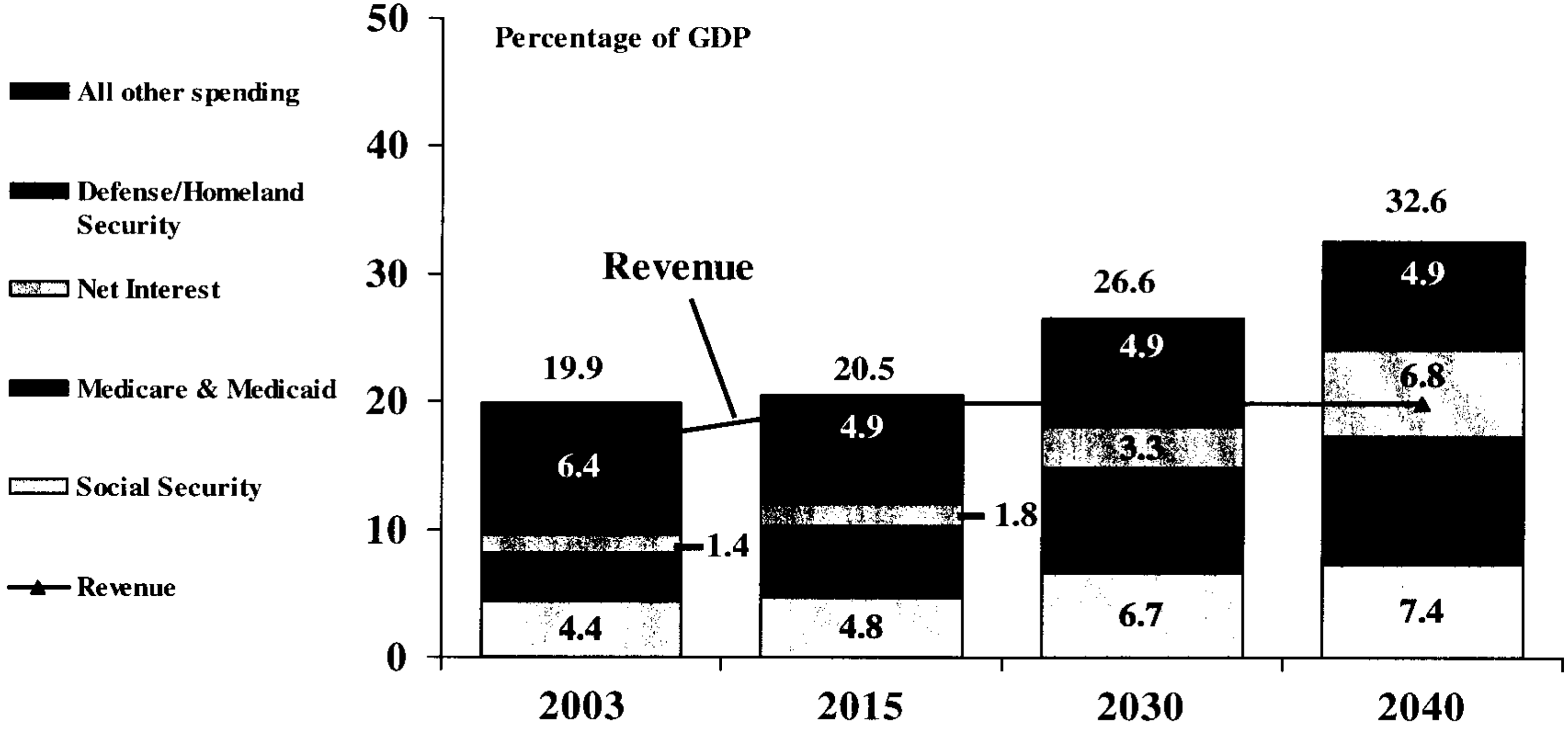
Further Selected Upcoming Changes to Corporate Income Tax Rules

	2003	2004	2005	2006	2007	2008	2009	2010	2011
Small Business Expensing	Deduction increased to $100K for qualifying property; reduced by amount property exceeds $400K. Both $100K deduction amount and $400K threshold subject to annual increases to reflect cost of living adjustment					Deduction declines to $25K, reduced by amount property exceeds $200K			
Bonus Depreciation	Increased to 50% of qualified property after 5/5/03		Bonus expires						

2003 2004 2005 2006 2007 2008 2009 2010 2011

The Long Term Fiscal Outlook: Projecting Beyond the Budget Window

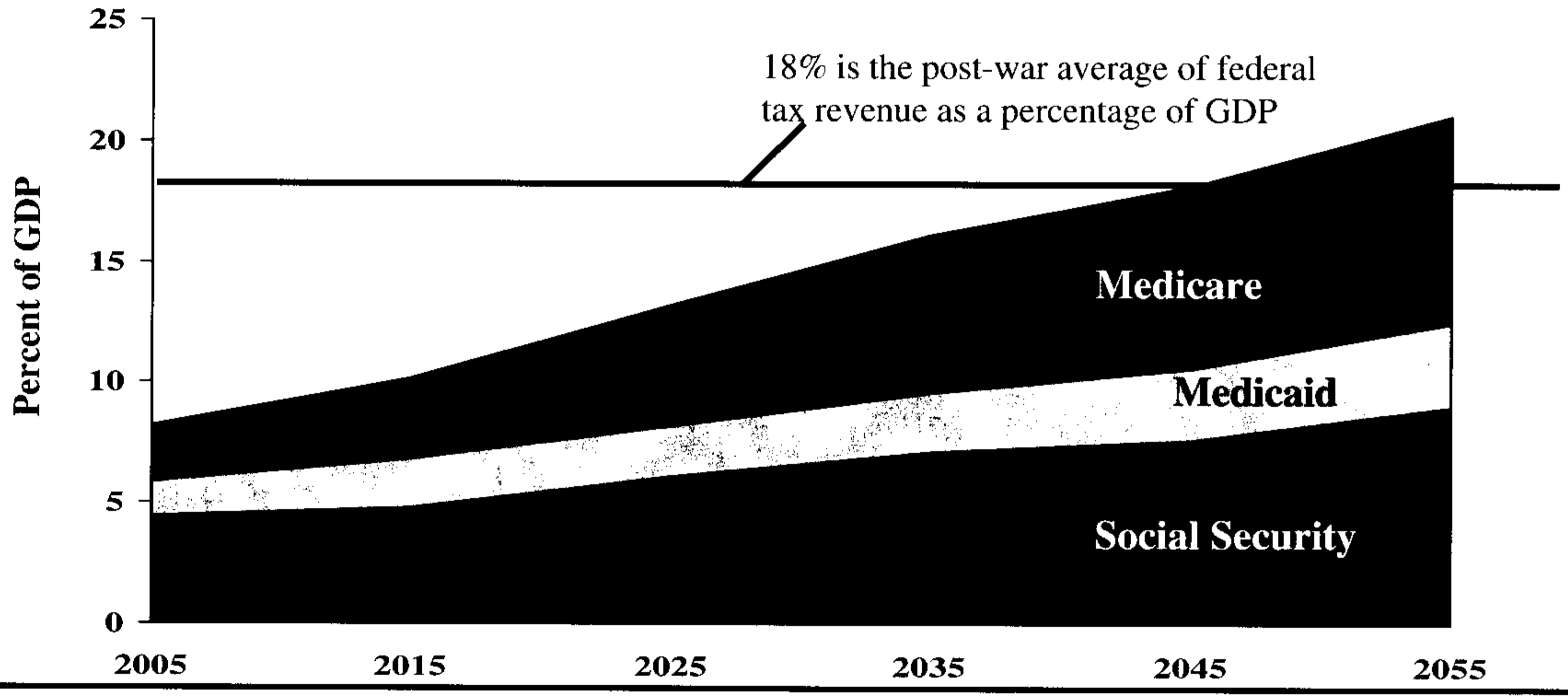
Composition of federal spending as a share of GDP, assuming discretionary spending grows with inflation until 2014 and with GDP thereafter, and all tax cut provisions expire (GAO Analysis)



Note: In addition to the expiration of tax cuts, revenue as a share of GDP increases through 2014 due to (1) real bracket creep, (2) more taxpayers becoming subject to the AMT, and (3) increased revenue from tax-deferred retirement accounts. After 2014, revenue as a share of GDP is held constant at 19.8%.

Source: GAO's baseline extended simulation as of Sept. 2004 available at http://www.gao.gov/special.pubs/longterm/dgdpns.pdf.

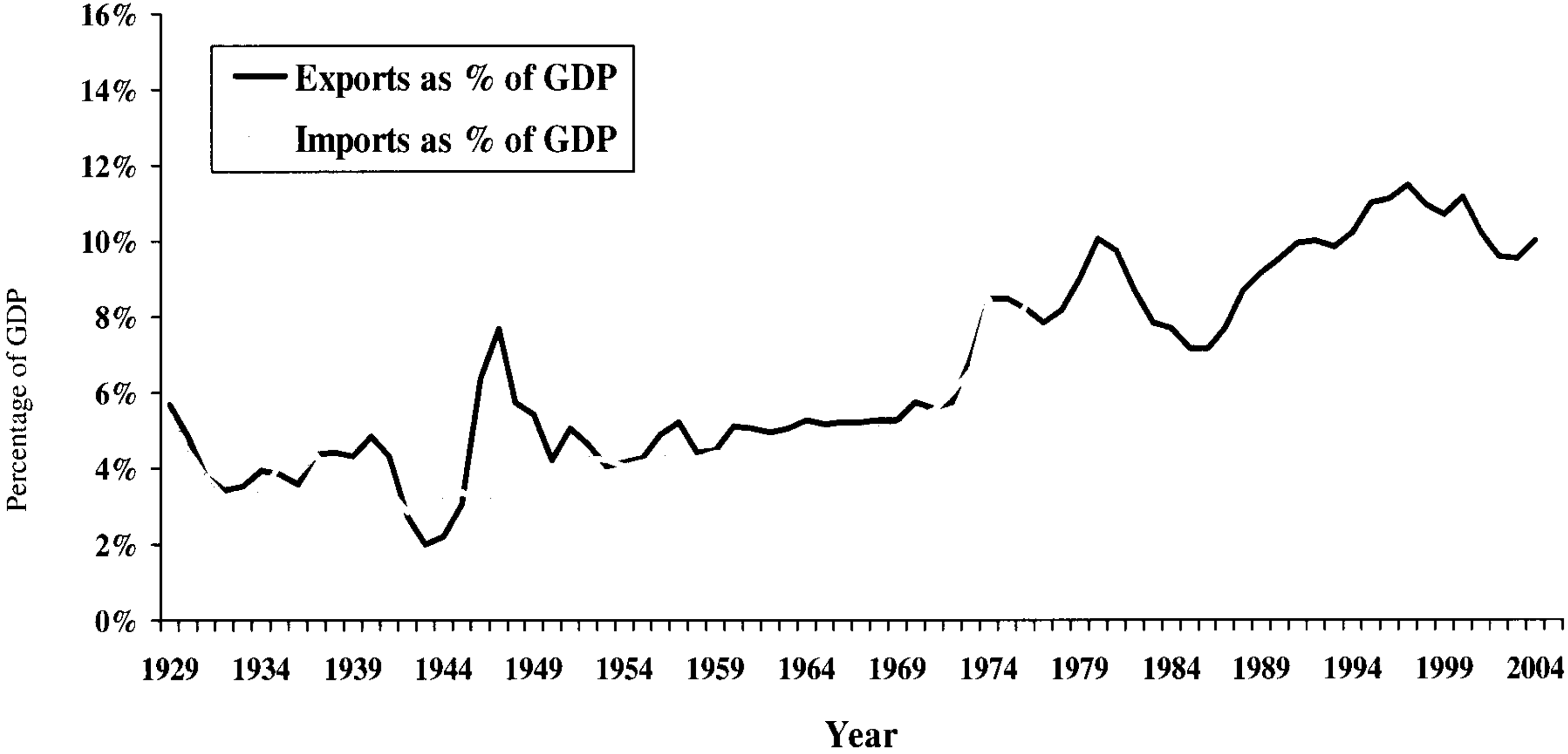
The Long Term Fiscal Outlook: Social Security, Medicare and Medicaid Spending as a Percent of GDP over Time



Note: Social Security and Medicare projections based on the intermediate assumptions of the 2004 Trustees' Reports. Medicaid projections based on CBO's January 2004 short-term Medicaid estimates and CBO's December 2003 long-term Medicaid projections under mid-range assumptions.
Source: GAO's Sept. 2004 baseline extended analysis; Bruce Bartlett, Tax Reform Agenda for the 109th Congress 15 (2004).

Global Trade: U.S. Imports and Exports over Time

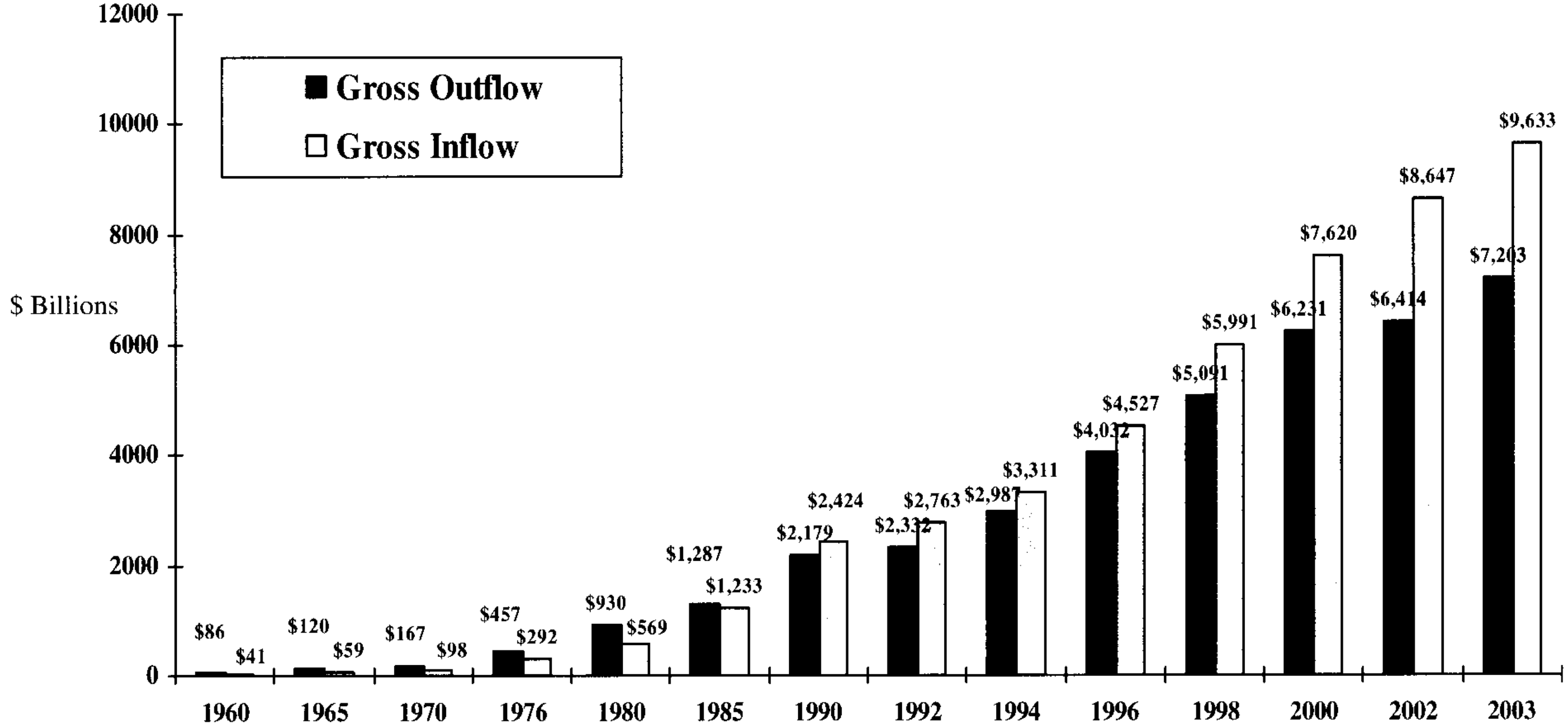
Global Trade: U.S. imports and exports as a percentage of gross domestic product: 1929-2004



Source: U.S. Department of Treasury, Bureau of Economic Analysis, National Economic Accounts, National Income and Product Accounts tbl. 1.1.5 Gross Domestic Product (last revised on January 28, 2005).

Globalization: Investment Flows into and out of the U.S. over Time

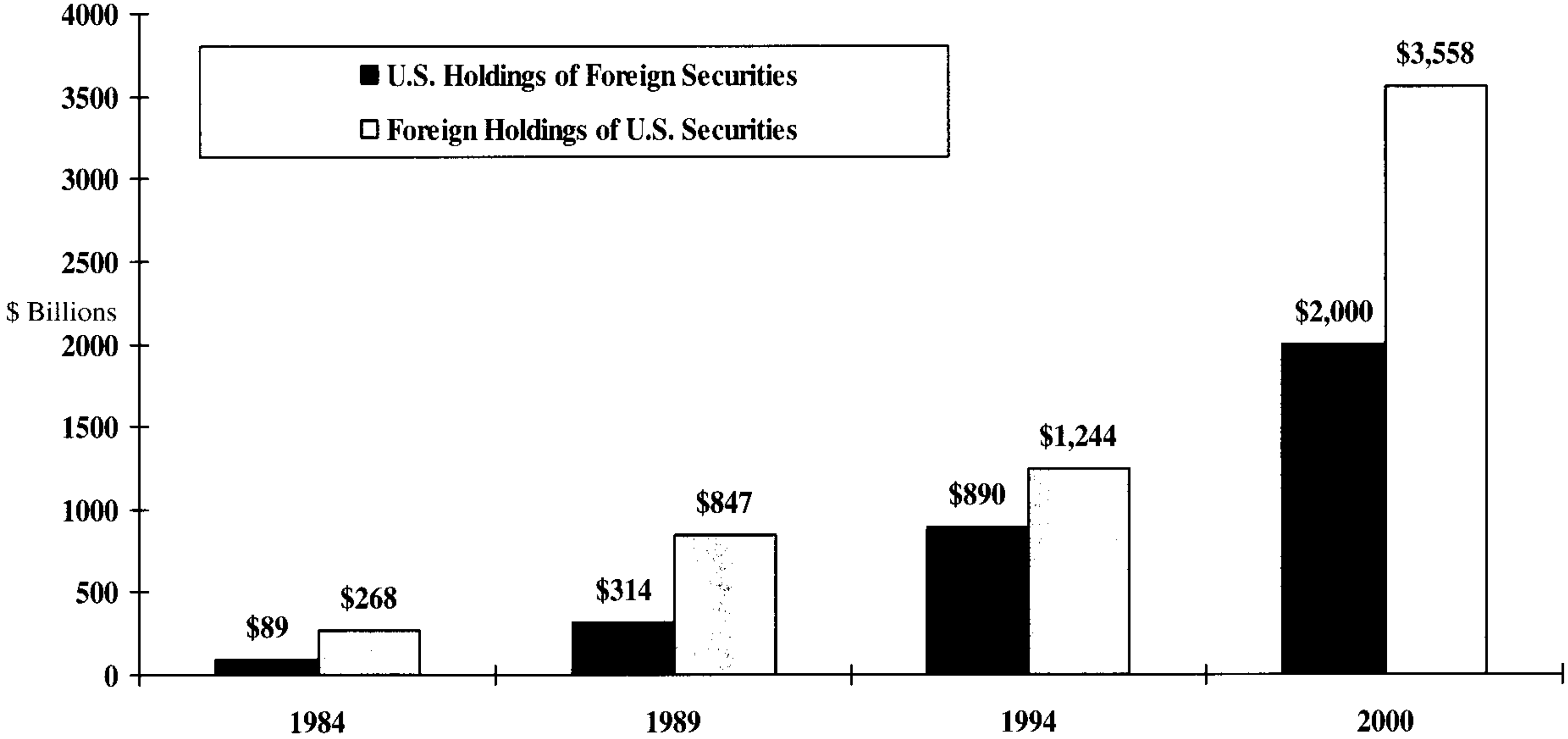
U.S.-owned assets abroad and foreign-owned assets in the U.S. using current-cost accounting method



Source: U.S. Department of Commerce, Bureau of Economic Analysis, data available at http://www.bea.gov/bea/di/home/iip.htm; Survey of Current Business, October 1972, Volume 52, Number 10, "The International Investment Position of the United States: Developments in 1971" by Russell Scholl.

Global Capital Markets: U.S. and Foreign Cross-border Portfolio Investment

U.S. holdings of foreign securities and foreign holdings of U.S. securities, as of December 31, 1984, 1989, 1994, and March 31, 2000



Source: Office of the Assistant Secretary, International Affairs, U.S. Department of Treasury, Report on Foreign Holdings of U.S. Long-term Securities, as of March 31, 2000, at 4 (April 2002).