Analysis of Estimated Effects on Fiscal Year Budget Receipts of the Revenue Provisions in the "Contract With America" (H.R. 6, H.R. 8, H.R. 9, H.R. 11)

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of the
Joint Committee on Taxation**

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INTRODUCTION

This document,[1] prepared by the staff of the Joint Committee on Taxation, provides information related to the estimated effects of the revenue provisions in the Contract With America (the "Contract") on budget receipts for fiscal years 1995-2005. The Contract was introduced by the House Leadership on January 4, 1995, and includes four bills that contain various tax proposals: H.R. 6 ("American Dream Restoration Act"); H.R. 8 ("Senior Citizens' Equity Act"); H.R. 9 ("Job Creation and Wage Enhancement Act"); and H.R. 11 ("Family Reinforcement Act").

There are 2 parts to this document. Part I of the document contains a brief overview of the revenue provisions in the Contract.[2] Part II is a discussion of assumptions relating to the Joint Committee on Taxation revenue estimates of the Contract tax provisions. An appendix provides a table of the estimated revenue effects of the Contract for fiscal years 1995-2005.

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[1] This pamphlet may be cited as follows: Joint Committee on Taxation, *Analysis of Estimated Effects on Fiscal Year Budget Receipts of the Revenue Provisions in the "Contract with America" (H.R. 6, H.R. 8, H.R. 9, H.R. 11)*, (JCX-4-95), February 6, 1995.

[2] For a more detailed description of present law and the tax proposals of the Contract, see Joint Committee on Taxation, *Description of Tax Proposals in the Contract With America* (JCS-1-95), January 9, 1995.

I. OVERVIEW OF REVENUE PROVISIONS IN THE CONTRACT WITH AMERICA

A. American Dream Restoration Act (H.R. 6)

1. Family tax credit (sec. 2 of the bill and sec. 35 of the Code)

The bill would provide taxpayers with a maximum refundable tax credit of $500 for each qualifying child. The credit would be phased out ratably for taxpayers with adjusted gross income ("AGI") over $200,000, and would be fully phased out at AGI of $250,000. In calendar years beginning after 1996, the maximum credit amounts and beginning point of the phaseout range would be indexed annually for inflation.

To be a qualifying child, an individual would have to satisfy a relationship test, a residency test, and an age test. The individual would satisfy the relationship test if the individual is a son, stepson, daughter, or stepdaughter of the taxpayer, a descendent of a son or daughter of the taxpayer, or a foster or adopted child of the taxpayer. An individual would satisfy the residency test if the individual has the same principal place of abode as the taxpayer for more than half the taxable year (the entire year for foster children). An individual would satisfy the age test if the individual has not attained the age of 18 as of the close of the calendar year in which the taxable year of the taxpayer begins.

The maximum amount of credit, regardless of the number of qualifying children, could not exceed an amount equal to the sum of: (1) the taxpayer's income tax liability (net of applicable credits), and (2) the taxpayer's Railroad Retirement Tier 1 tax and Social Security tax (SECA and the employee and employer share of FICA), less the taxpayer's allowable earned income tax credit.

The provision would be effective for taxable years beginning after December 31, 1995.

2. Credit to reduce the marriage penalty (sec. 3 of the bill and new sec. 23 of the Code)

Married couples who file a joint return and have a larger tax liability than if they were unmarried and filed individual returns would be eligible for a nonrefundable credit against their income tax liability. The amount of the credit would be determined by the Department of the Treasury so that the estimated reduction in revenues to the Treasury would not exceed $2 billion per fiscal year. In no event would the credit for a particular taxpayer be larger than the size of the marriage penalty the couple would face without the provision.

The provision would be effective for taxable years beginning after the date of enactment.

3. Establishment of American Dream Savings Accounts (sec. 4 of the bill and sec. 408A of the Code)

The bill would permit individuals to establish and maintain an American Dream Savings Account (ADS account) to which they can make nondeductible contributions. Contributions to an ADS account would be in addition to any contributions that can be made to an IRA under the present-law rules. An ADS account would be an IRA which is designated at the time of establishment as an ADS account. Qualified distributions from an ADS account would not be includible in income.

The maximum annual contribution that could be made to an ADS account would be the lesser of $2,000 or the individual's compensation for the year. In the case of a married couple, the aggregate compensation of the couple would be taken into account in determining the maximum permitted contribution. The $2,000 contribution limit would be adjusted annually for inflation beginning after 1996.

Qualified distributions from an ADS account would not be includible in gross income, nor subject to the additional 10-percent tax on early withdrawals. A qualified distribution would be a distribution (1) that is made after the 5-taxable year period beginning with the first taxable year in which the individual made a contribution to an ADS account, and (2) that is (a) made on or after the date on which the individual attains age 59-1/2, (b) made to a beneficiary (or to the individual's estate) on or after the death of the individual, (c) attributable to the individual's being disabled, or (d) a qualified special purpose distribution. Qualified special purpose distributions would be distributions for the purchase or acquisition of a principal residence of a first-time homebuyer, for higher education expenses of the taxpayer, the taxpayer's spouse, or the taxpayer's child or grandchild, for medical expenses, or for long-term care insurance premiums.

Distributions from an ADS account other than qualified distributions would be includible in gross income under the rules applicable to distributions from IRAs and subject to the 10-percent tax on early withdrawals.

Distributions from ADS accounts could be rolled over tax free to another ADS account. In addition, amounts withdrawn from an IRA could be rolled over to an ADS account after December 31, 1995, and before January 1, 1998. The amount otherwise includible in gross income due to the IRA distribution would be included in gross income ratably over the 4-taxable year period beginning with the taxable year in which the distribution is made. The early withdrawal tax would not apply to such rollovers.

The provision would be effective for taxable years beginning after December 31, 1995.

B. Senior Citizens' Equity Act (H.R. 8)

1. Repeal of increase in tax on social security benefits (secs. 86 and 871(a)(3) of the Code)

In general

The bill would phase in a repeal of the provision included in the Omnibus Budget Reconciliation Act of 1993 requiring certain taxpayers to include up to 85 percent of certain social security benefits in income.

For taxable years beginning after calendar year 1995, the amount of certain social security benefits required to be included in income would be calculated as under present law, except that the following rates would be substituted for "85 percent":

For taxable years beginning in calendar year:	*The percentage would be:*
1996	75 percent
1997	65 percent
1998	60 percent
1999	55 percent
2000 and thereafter	50 percent.

The bill would also phase in a reduction under the same schedule in the amount of social security or Railroad Retirement tier 1 benefits included in the gross income of a nonresident alien individual under the same schedule.

The provision would be effective for taxable years beginning after December 31, 1995.

2. Treatment of long-term care (secs. 301-305, and 307 of the bill and secs. 104, 106, 213, 807(d), 1035, and 4980B and new secs. 137 and 818A of the Code)

In general

The bill would provide that qualified long-term care insurance contracts that meet the requirements of the bill receive the tax treatment set forth in the bill. Other long-term care contracts would continue to be subject to present law.

Insurance company taxation

The bill would generally provide that, for purposes of the Internal Revenue Code rules relating to taxation of insurance companies, a qualified long-term care insurance contract would be treated as accident or health insurance. In determining reserves for insurance company taxation purposes, the reserve method for qualified long-term insurance contracts would be a 1-year full preliminary term method.

Exclusion for benefits provided under long-term care insurance; exclusion for employer-provided coverage

The bill would provide that benefits paid under a qualified long-term care insurance contract are excludable from gross income to the extent the benefits do not exceed $200 per day (indexed for inflation after 1995). The $200 limit is applied separately to each qualified long-term care contract. In addition, employer contributions for qualified long-term care insurance would be excludable from gross income. In applying the bill's $200 limit on daily coverage under a qualified long-term care insurance contract for purposes of this exclusion, all contracts provided to the employee by the same employer would be aggregated. The bill would not permit qualified long-term care coverage to be provided through a cafeteria plan.

Long-term care services treated as medical care

The bill would provide that expenses for qualified long-term care services are treated as expenses for medical care for purposes of the itemized deduction for medical expenses. Thus, under the bill, a taxpayer would be allowed an itemized deduction for unreimbursed qualified long-term care expenses to the extent that such expenses and other eligible medical expenses of the taxpayer exceed 7.5 percent of adjusted gross income.

In addition, under the bill, eligible medical expenses for purposes of the medical expense deduction would include premiums paid for qualified long-term care insurance to the extent they do not exceed the following amounts:

In the case of an individual with an attained age before the close of the taxable year of:	***The limitation is:***
Not more than 40	200
More than 40 but not more than 50	375
More than 50 but not more than 60	750
More than 60 but not more than 70	2,000
More than 70	2,500

Beginning after 1995, these dollar limits would be indexed for increases in the medical care cost component of the consumer price index.

Exclusion from income for amounts withdrawn from IRAs and section 401(k) plans for long-term care insurance

The bill would provide that distributions from individual retirement arrangements (IRAs) and qualified cash or deferred arrangements (sec. 401(k) plans) are excludable from gross income to the extent used to pay premiums on a qualified long-term care insurance contract. In the case of distributions from a section 401(k) plan, such tax treatment would apply only to distributions of elective deferrals. A section 401(k) plan would not fail to be a qualified cash or deferred arrangement merely because it permits distributions which are excludable from income under the bill.

The provisions generally would be effective for taxable years beginning after December 31, 1995.

3. Tax treatment of accelerated death benefits under life insurance contracts (sec. 306 of the bill and sec. 101 of the Code)

The bill would provide an exclusion from gross income for any amount paid or advanced to an individual under a life insurance contract if the insured under the contract is either (1) terminally ill or (2) chronically ill and confined to a qualified facility.

For this purpose, an individual would be considered terminally ill if a physician has certified that the individual has an illness or physical condition that reasonably can be expected to result in death within 12 months of the certification. A "chronically ill individual" would mean any individual who has been certified by a licensed health care practitioner as (1) being unable to perform (without substantial assistance) at least two activities of daily living for a period of at least 90 days due to a loss of functional capacity, (2) having a level of disability (as determined by the Department of the Treasury in consultation with the Department of Health and Human Services) similar to the level of disability described in (1), or (3) having a similar level of disability due to cognitive impairment.

The provision would apply to taxable years beginning after December 31, 1995.

C. Job Creation And Wage Enhancement Act (H.R. 9)

1. Capital gains reforms (Title I of the bill)

a. 50-percent capital gains deduction (sec. 1001 of the bill and secs. 1201 and 1202 of the Code)

The bill would allow all taxpayers (both individual and corporate) a deduction equal to 50 percent of net capital gain for the taxable year. The bill would repeal the present-law maximum 28-percent rate. Thus, the effective rate on the net capital gain of an individual in the highest (i.e., 39.6 percent) rate bracket would be 19.8 percent, and the effective rate for a corporation in the 35-percent bracket would be 17.5 percent.

The bill would repeal the provisions in the Revenue Reconciliation Act of 1993 providing a capital gain exclusion for sales of certain small business stock.

The bill would reinstate the rule in effect prior to the Tax Reform Act of 1986 that required two dollars of the long-term capital loss of an individual to offset one dollar of ordinary income. The $3,000 limitation on the deduction of capital losses against ordinary income would continue to apply.

The provision generally would apply to taxable years ending after December 31, 1994. For a taxpayer's 1994-95 fiscal year or for the 1995 calendar year of a taxpayer holding interests in one or more 1994-95 fiscal year pass-thru entities, the 50-percent capital gains deduction would apply to the lesser of (1) the net capital gain for the taxable year, or (2) the net capital gain determined by taking into account gain or loss properly taken into account for the portion of the taxable year on or after January 1, 1995.

b. Indexing of basis of certain assets for purposes of determining gain or loss (sec. 1002 of the bill and new sec. 1022 of the Code)

The bill generally would provide for an inflation adjustment to (i.e., indexing of) the basis of certain assets (called "indexed assets") for purposes of determining gain or loss upon a sale or other disposition of such assets. Assets the basis of which would be eligible for the inflation adjustment generally would include corporate stock and tangible property that are capital assets or property used in a trade or business and are held by the taxpayer for more than one year. The inflation adjustment would be measured by increases in the Gross Domestic Product ("GDP") deflator occurring after December 31, 1994, regardless of whether the asset was acquired by the taxpayer prior to that date.

Special rules would be provided in the case of regulated investment companies (RICs), real estate investment trusts (REITs), partnerships, S corporations, foreign corporations, short sales, sales to related persons, and collapsible corporations.

The provisions would apply to dispositions of property after December 31, 1994, in taxable years ending after that date.

c. Capital loss deduction allowed with respect to sale or exchange of a principal residence (sec. 1003 of the bill and sec. 165 of the Code)

The bill would provide that losses from the sale or exchange of a principal residence would be treated as a deductible capital loss rather than a nondeductible personal loss.

The provision would be effective for sales and exchanges after December 31, 1994, in taxable years ending after such date.

2. Neutral cost recovery (Title II of the bill and secs. 56 and 168 of the Code)

For MACRS property placed in service after December 31, 1994, the bill would allow a taxpayer to elect, on a property-by-property basis, to determine depreciation deductions under present law or under a new neutral cost recovery system (NCRS). NCRS generally would follow MACRS but would replace the 200-percent declining balance method of MACRS with the 150-percent declining balance method. In addition, depreciation for any taxable year after the year in which the property is placed in service would be determined by multiplying the deduction allowable for the property for the taxable year (determined without regard to this provision) by the "applicable neutral cost recovery ratio" for the year.

In the case of property that would otherwise qualify for the 200-percent declining balance method (but for the election to use NCRS), the applicable neutral cost recovery ratio for the year would be first determined by dividing (1) the GDP deflator for the calendar quarter ending in such taxable year which corresponds to the calendar quarter during which the property was placed in service by the taxpayer by (2) the GDP deflator for the calendar quarter during which the property was placed in service by the taxpayer. This ratio would then be multiplied by the number equal to 1.035 to the nth power, where "n" is the number of full years in the period beginning on the first day of the calendar quarter during which the property was placed in service and ending on the day before the beginning of the corresponding calendar quarter ending during the taxable year. In the case of other MACRS property (e.g., longer-lived property and property to which the alternative depreciation system applies), the applicable neutral cost recovery ratio for the year would be determined by dividing (1) the GDP deflator for the calendar quarter ending in such taxable year which corresponds to the calendar quarter during which the property was placed in service by the taxpayer by (2) the GDP for the calendar quarter during which the property was placed in service by the taxpayer. For any property, the applicable neutral cost recovery ratio may not be less than 1 and would be rounded to the nearest one-thousandth.

The applicable neutral cost recovery ratio also would be applied for purposes of determining depreciation under the alternative minimum tax (including the adjusted current

earnings adjustment of the corporate alternative minimum tax).

The provision would be effective for qualifying property placed in service after December 31, 1994.

3. Public debt reduction checkoff and trust fund (Title XI of the bill and new secs. 6097 and 9512 of the Code)

Individual taxpayers would be allowed to designate an amount up to 10 percent of their Federal income tax liability for a taxable year to be earmarked to reduce the Federal public debt. Under the bill, amounts earmarked by taxpayers to reduce the public debt would be transferred into a Public Debt Reduction Trust Fund ("Trust Fund"), which would be used only to retire or purchase Federal securities. If Congress did not enact specific spending cuts equal to the estimated amounts designated by taxpayers for debt reduction, then an across-the-board sequestration would be triggered (other than for certain payments such as social security).

The provision would be effective for taxable years ending after the date of enactment, and would remain in effect until the entire outstanding Federal public debt is retired.

4. Small business incentives (Title XII of the bill)

a. Increase in unified estate and gift tax credits (sec. 12001 of the bill and secs. 2001(c), 2010, 2102(c)(3), 2505(a) and 6018(a) of the Code)

The bill would gradually increase the present-law unified estate and gift tax credit of $192,800 to $248,300 over a three-year period beginning in 1996. For decedents dying and gifts made in 1996, the unified credit would be $229,800 (i.e., the amount that would effectively exempt $700,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made in 1997, the unified credit would be $239,050 (i.e., the amount that would effectively exempt $725,000 in taxable transfers from the estate and gift tax). For decedents dying and gifts made after 1997, the unified credit would be $248,300 (i.e., the amount that would effectively exempt $750,000 in taxable transfers from the estate and gift tax). After 1998, the unified credit would be indexed for inflation each year by multiplying the applicable exclusion amount of $750,000 by a cost of living adjustment.

Conforming amendments to reflect the increased unified credit would be made (1) to the 5-percent surtax in order to permit the proper phase out of the increased unified credit, (2) to the general filing requirements for an estate tax return under section 6018(a), and (3) to the amount of the unified credit allowed under section 2102(c)(3) with respect to nonresident aliens with U.S. situs property who are residents of certain treaty countries.

The provision would apply to the estates of decedents dying, and gifts made, after December 31, 1995.

b. Increase in expensing treatment for small businesses (sec. 12002 of the bill and sec. 179 of the Code)

The bill would increase the $17,500 amount allowed to be expensed under Code section 179 to $25,000. The provision would be effective for property placed in service in taxable years beginning after December 31, 1995.

c. Clarification of definition of principal place of business; Treatment of storage of product samples (secs. 12003 and 12004 of the bill and sec. 280A of the Code)

The bill would amend present-law section 280A to provide specifically that a home office qualifies as the "principal place of business" if (1) the office is the location where the taxpayer's essential administrative or management activities are conducted on a regular and systematic (and not incidental) basis by the taxpayer, and (2) the office is necessary because the taxpayer has no other location for the performance of the administrative or management activities of the business. As under present law, deductions would be allowed for a home office meeting the above two-part test only if the office is used exclusively as a place of business by the taxpayer, and in the case of an employee, only if such exclusive use is for the convenience of the employer.

In addition, the bill would clarify that the special rule contained in present-law section 280A(c)(2) permits deductions for expenses related to a storage area in a taxpayer's home regularly used for inventory or product samples (or both) of the taxpayer's trade or business of selling products at retail or wholesale, provided that the home is the sole fixed location of such trade or business.

The provision would apply to taxable years beginning after 1995.

D. Family Reinforcement Act (H.R. 11)

1. Refundable credit for adoption expenses (sec. 101 of the bill and sec. 35 of the Code)

The bill would provide taxpayers with a maximum refundable tax credit of $5,000 per child for qualified adoption expenses paid or incurred by the taxpayer. Qualified adoption expenses would be reasonable and necessary adoption fees, court costs, attorneys' fees and other expenses that are directly related to the legal adoption of a child. No credit would be allowed for expenses incurred in connection with the violation of State or Federal law, any surrogate parenting arrangement, or the adoption of a child of the taxpayer's spouse. The credit would be phased out ratably for taxpayers with adjusted gross income (AGI) above $60,000 and would be fully phased out at $100,000 of AGI.

The provision would be effective for taxable years beginning after December 31, 1995.

2. Refundable credit for custodial care of certain elderly dependents in taxpayer's home (sec. 201 of the bill and new sec. 36 of the Code)

The bill would provide taxpayers who maintain a household including one or more "qualified persons" with a refundable credit of $500 for each qualified person.

To be a "qualified person," an individual would have to pass a relationship test, a residency test and a disability test. The individual would satisfy the relationship test if the individual is a (1) father, stepfather, mother or stepmother of either the taxpayer, the taxpayer's spouse or the taxpayer's former spouse, or (2) a father, stepfather, mother or stepmother of one of the people described in (1). An individual would satisfy the residency test if the individual has the same principal place of abode as the taxpayer for more than half of the taxable year. An individual would satisfy the disability test if the individual is certified by a physician as being unable to perform at least two activities of daily living without substantial assistance from another individual.

The provision would be effective for taxable years beginning after December 31, 1995.

II. DISCUSSION OF ASSUMPTIONS RELATING TO THE JOINT COMMITTEE ON TAXATION REVENUE ESTIMATES OF THE CONTRACT WITH AMERICA

A. Relevant Assumptions Made with Respect to Revenue Provisions Contained in the Contract With America

In general

A number of the revenue provisions in the Contract With America are assumed to have relatively small effects on taxpayer behavior. For example, the family tax credit is not assumed to have any substantial effect on taxpayer behavior; thus, it is not assumed that the family tax credit will result in more taxpayers having children. Similarly, taxpayer behavior is not a significant component of the estimate of the effect of repealing the tax increase on certain social security benefits. Other provisions in the Contract With America that are not expected to involve significant changes in taxpayer behavior include the following: (a) the capital loss deduction on the sale of a principal residence; (b) increases in the unified estate and gift tax credit; (c) the tax credit for custodial care of certain elderly dependents; and (d) modifications to the home office deduction.

It is assumed for estimating purposes that the adoption tax credit will result in some increase in the number of adoptions.

American Dream Savings Accounts

The American Dream Savings ("ADS") account revenue estimate has the following three components: (a) the revenue loss attributable to excluding earnings of ADS accounts from tax; (b) the short-term revenue gain associated with rollovers from conventional Individual Retirement Arrangements ("IRAs"); and (c) the revenue effects attributable to the special purpose withdrawal provisions.

Earnings on ADS account balances are not subject to income tax at the time earned nor subject to tax at the time withdrawals are made from the account upon the occurrence of specified events. Reductions in taxes paid on interest earnings are included in the estimate, to the extent that the interest would have been earned on a taxable savings accounts. Thus, a principal revenue effect of the provision, particularly over the long term, is the revenue loss that occurs because taxpayers contribute amounts to ADS accounts that otherwise would have been invested in taxable savings. It is assumed that, in most cases, particularly at higher income levels, typical savings patterns are not altered by the introduction of the ADS account except for this shifting between taxable and nontaxable savings. To the extent that ADS accounts result in savings that would not have otherwise occurred, there is no revenue loss attributable to such new savings because they do not represent losses relative to the revenue baseline.

Rollovers from IRAs are permitted during the first two years after introduction of the ADS account. Taxable amounts withdrawn from IRAs are ratably includible in income during the four tax years following the withdrawal. It is assumed for estimating purposes that some taxpayers will utilize this rollover option. Rollovers to ADS accounts represent a revenue increase, to the extent that taxpayers incur higher tax liabilities than they would in the absence of the rollovers.

A small revenue loss is included for amounts transferred from conventional IRAs because withdrawals from ADS accounts can be made for special purpose withdrawals (i.e., withdrawals for first-time home purchase, educational expense, or catastrophic health costs). It is assumed that some taxpayers who would have withdrawn amounts from their IRAs and paid the 10-percent early withdrawal tax will roll over their IRA balances to ADS accounts and withdraw the amounts, without penalty, for special purpose withdrawals. This revenue effect represents the loss attributable to the 10-percent additional tax on early withdrawals and is reflected outside the five-year budget period.

Long-term care provisions

The estimate of the long-term care provisions is based on several assumptions. First, it is assumed that the provision allowing individuals to deduct long-term care insurance premiums under certain conditions will result in an increase in the purchase of long-term care insurance policies. Second, it is assumed that the general clarification of the tax treatment of long-term care and the specific provision allowing individuals to deduct expenses related to long-term care needs will result in an increase in the consumption of services provided by paid caregivers. Third, it is assumed that the provision allowing tax-free exchanges of life insurance policies will increase the purchases of additional life insurance policies and that the provision allowing withdrawals from IRAs and section 401(k) plans will result in an increase in the utilization of these tax-favored savings vehicles.

Neutral cost recovery

Two behavioral effects were included in the revenue estimate for the neutral cost recovery system ("NCRS"). First, under NCRS, taxpayers may elect present-law cost recovery on a property-by-property basis. The NCRS estimate assumes that taxpayers will make this election when the underlying property (a) qualifies for the present-law 200-percent declining balance method and (b) the property is expected to be held for a short period of time. For example, it is assumed that taxpayers may, in many cases, prefer present-law depreciation for certain business cars and computers. Furthermore, taxpayers who have immediate cash-flow limitations may also elect out of NCRS in favor of present-law treatment. Second, the estimate assumes that existing depreciable assets will experience an increase in turnover (i.e., sale or other disposition) in order to take advantage of the indexing feature of NCRS. This turnover (i.e., sale or other disposition) produces additional revenue in the near term as a result of

taxable gains on the sale of depreciable property, and it produces additional revenue loss in the out years as depreciation deductions are increased.

Expensing

The expensing estimate assumes that taxpayers will generally elect to expense qualifying property when possible. This election generates a speed up in depreciation deductions. As a result, the revenue losses diminish after the initial years under the proposal due to the offsetting effect of no depreciation deductions in later years for properties that have previously been expensed.

Capital gains

The estimates of the proposed changes in the taxation of capital gains requires adjustment of the CBO baseline forecast of capital gains to incorporate the behavioral changes anticipated by these proposals. These behavioral changes include induced realizations from the proposals' "unlocking effect" (i.e., that taxpayers will sell assets that would not have been sold in the absence of a reduction in the rate of tax on capital gains) and the ability of taxpayers to convert ordinary income to capital gains (the portfolio effect). The magnitude of this adjustment for behavioral changes is large. For example, the 50-percent capital gains deduction is estimated to cause more than a 50-percent surge in total baseline gains realized in the fiscal year 1995-2000 budget period.

B. Potential Macroeconomic Effects of the Contract With America Revenue Provisions

The tax provisions of the Job Creation and Wage Enhancement Act (H.R.9) would generally increase the after-tax rate of return on capital, which would thereby promote increases in saving and investment. The resulting enhancement of the capital stock can be expected to increase economic productivity, providing for an increase in the rate of growth of the economy. As these increases in productivity and economic growth accumulate over time, they will lead to a gradual expansion of the taxable income base, generating additional tax revenues. These effects would be most pronounced in the capital gains reform and the Neutral Cost Recovery system proposals. However, the magnitude of the economic expansion and the speed at which it would take place are subject to widely varying estimates.

The provisions in the "American Dream Restoration Act" (H.R.6) may also be expected to have some effect on the long-run growth of the economy. The $500 per child tax credit is likely to reduce the supply of labor to the economy because the amount of the tax benefit afforded to most families is independent of their amount of work effort. The additional after-tax income afforded by the benefit may allow some family members to reduce their work effort. This provision would likely result in a small reduction in the supply of labor, which would be expected to reduce the rate of growth of the economy, resulting in a contraction of the tax base

and a slight reduction in Federal individual income tax revenues. The refundable credit for custodial care of certain elderly dependents could be expected to have a similar small effect on the economy.

The "marriage penalty" credit, which may reduce the marginal tax rate on the earnings of the second earner of the couple, may cause the second earner to be willing to work more, thus increasing the supply of labor to the economy. At this time, the proposal is not sufficiently detailed to provide information about its effect on the marginal tax rate of the second earner. However, the amount of the tax savings per household is so small that it is likely that any such effect would be negligible for the economy as a whole.

The American Dream Savings account provision can be expected to increase the after-tax return to a portion of a household's savings. Therefore, it might be expected to induce new savings, resulting in the eventual growth in the economy described above with respect to the Job Creation and Wage Enhancement Act. The experience with the extent to which IRAs promote new savings should be instructive in examining whether ADS accounts will have a similar effect. Numerous studies have attempted to measure the extent to which IRAs have contributed to an increase in overall savings, but the results of these studies have been inconclusive. ADS accounts might be expected to be more likely to promote new savings because the withdrawal provisions are less restrictive than the IRA withdrawal provisions. However, it is anticipated that in most cases these accounts would be established with existing savings, or savings that would have occurred in any event. If that is the case, then the amount of new savings induced by this proposal is likely to be small, and the proposal's effect on the rate of growth of the economy and future tax revenues would be correspondingly small.

In general, the provisions in the other portions of the Contract with America would not be expected to affect the rate of growth of GDP. The tax savings that are provided under these provisions are generally sufficiently small that they are unlikely to affect significantly either the supply of labor or the supply of capital to the economy.

It is reasonable to expect that all of the revenue provisions in the Contract With America could have cyclical impacts on GDP. Most of these provisions will result in an increase in taxpayer disposable income. By affecting disposable income, these provisions would produce increases in aggregate demand that could generate a temporary expansion of the economy. The magnitude and duration of these cyclical effects would be highly dependent on the degree to which the Federal Reserve Board's monetary policies accommodate or offset these demand effects.

Joint Committee on Taxation
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APPENDIX. - -
ESTIMATED REVENUE EFFECTS OF THE TAX PROVISIONS CONTAINED IN THE "CONTRACT WITH AMERICA"
(H.R. 6, H.R. 8, H.R. 9, AND H.R. 11)

Fiscal Years 1995 - 2005 [1]

[Billions of Dollars]

Provision	Effective	1995	1996	1997	1998	1999	2000	1995-00	2001	2002	2003	2004	2005	1995-05
I. American Dream Restoration Act (H.R. 6)														
A. Family Tax Credit (section 2)...................	1/1/96	---	-5.2	-26.0	-26.9	-29.4	-29.9	-117.5	-30.9	-33.8	-35.0	-38.2	-39.6	-295.1
B. Credit to Reduce the Marriage Penalty (section 3)..	tyba DoE	---	-0.2	-2.0	-2.0	-2.0	-2.0	-8.2	-2.0	-2.0	-2.0	-2.0	-2.0	-18.2
C. Establishment of American Dream Savings Accounts (section 4)...............................	1/1/96	---	1.2	1.7	1.0	0.2	-2.0	2.2	-4.4	-4.2	-5.0	-5.7	-6.7	-23.9
TOTAL, H.R. 6		**---**	**-4.2**	**-26.3**	**-27.9**	**-31.2**	**-33.9**	**-123.5**	**-37.3**	**-40.0**	**-42.0**	**-45.9**	**-48.3**	**-337.2**
II. Senior Citizens' Equity Act (H.R. 8)														
A. Repeal of Increase in Tax on Social Security Benefits (Title II).........................	1/1/96	---	-0.5	-1.9	-3.2	-4.3	-5.6	-15.6	-6.7	-7.4	-8.1	-8.9	-9.7	-56.3
B. Treatment of Long-Term Care (sections 301-305, and 307)..................................	1/1/96	---	-0.8	-0.9	-1.0	-1.2	-1.4	-5.4	-1.7	-2.0	-2.3	-2.6	-3.0	-16.9
C. Tax Treatment of Accelerated Death Benefits under Life Insurance Contracts (section 306)..	1/1/96	---	[2]	[2]	[2]	[2]	[3]	-0.1	[3]	-0.1	-0.1	-0.2	-0.2	-0.9
TOTAL, H.R. 8		**---**	**-1.3**	**-2.8**	**-4.2**	**-5.5**	**-7.1**	**-21.1**	**-8.5**	**-9.5**	**-10.5**	**-11.7**	**-12.9**	**-74.1**
III. Job Creation and Wage Enhancement Act (H.R. 9)														
A. Capital Gains Reforms (Title I)														
1. 50-percent capital gains deduction (section 1001):														
a. Individual.......................................	1/1/95	0.4	2.3	-2.6	-6.6	-7.3	-7.9	-21.7	-8.6	-9.4	-10.3	-11.2	-12.2	-73.4
b. Corporate.....................................	1/1/95	-1.2	-2.6	-2.7	-2.8	-2.9	-2.9	-15.1	-2.9	-3.0	-3.0	-3.1	-3.1	-30.3

Provision	Effective	1995	1996	1997	1998	1999	2000	1995-00	2001	2002	2003	2004	2005	1995-05
2. Indexing of basis of certain assets for purposes of determining gain or loss (section 1002)	1/1/95	-0.2	-0.8	-1.4	-2.2	-2.9	-3.7	-11.2	-4.6	-5.6	-6.7	-7.9	-9.2	-45.2
3. Capital loss deduction allowed with respect to sale or exchange of principal residence (section 1003)	1/1/95	---	-0.1	-0.1	-0.1	-0.2	-0.2	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-1.6
4. Interaction among provisions [4]	1/1/95	-0.2	-0.6	-0.8	-0.9	-1.2	-1.5	-5.2	-1.9	-2.4	-2.9	-3.4	-4.0	-19.8
B. Neutral Cost Recovery (Title II)	pplsa 12/31/94	1.2	9.2	10.0	6.3	-1.2	-8.8	16.7	-14.2	-18.1	-21.3	-24.3	-27.5	-88.8
C. Public Debt Reduction Checkoff and Trust Fund Title XI)	tyba DoE	*No Revenue Effect*												
D. Small Business Incentives (Title XII)														
1. Increase in unified estate and gift tax credits (section 12001)	1/1/96	---	---	-1.4	-1.6	-1.8	-2.0	-6.8	-2.2	-2.5	-2.8	-3.1	-3.5	-20.7
2. Increase in expense treatment for small businesses (section 12002)	tyba 12/31/95	---	-0.8	-1.2	-0.8	-0.6	-0.4	-3.8	-0.3	-0.2	-0.1	-0.1	[2]	-4.5
3. Clarification of definition of principal place of business; Treatment of storage of product samples (sections 12003 and 12004)	tyba 12/31/95	---	-0.1	-0.2	-0.1	-0.2	-0.2	-0.7	-0.2	-0.2	-0.2	-0.2	-0.2	-1.6
TOTAL, H.R. 9 [5]		**---**	**6.5**	**-0.4**	**-8.8**	**-18.3**	**-27.6**	**-48.5**	**-35.1**	**-41.6**	**-47.5**	**-53.5**	**-59.9**	**-285.9**
IV. Family Reinforcement Act (H.R. 11)														
A. Refundable Credit for Adoption Expenses (section 101)	1/1/96	---	[2]	-0.3	-0.3	-0.3	-0.3	-1.3	-0.3	-0.3	-0.3	-0.3	-0.3	-3.0
B. Refundable Credit for Custodial Care of Certain Elderly Dependents in Taxpayer's Home (section 201)	1/1/96	---	-0.1	-0.5	-0.4	-0.4	-0.4	-1.9	-0.5	-0.5	-0.5	-0.5	-0.5	-4.2
TOTAL, H.R. 11		**---**	**-0.1**	**-0.8**	**-0.7**	**-0.7**	**-0.7**	**-3.2**	**-0.8**	**-0.8**	**-0.8**	**-0.8**	**-0.8**	**-7.2**
NET TOTALS (H.R. 6, H.R. 8, H.R. 9, H.R. 11) [6]		**---**	**0.9**	**-30.4**	**-41.6**	**-55.7**	**-69.2**	**-196.3**	**-81.7**	**-91.9**	**-100.8**	**-111.9**	**-121.9**	**-704.4**

Joint Committee on Taxation

NOTE: Details may not add to totals due to rounding.

[Legend and Footnotes appear on following page]

Legend and Footnotes for JCX-4-95:

Legend for "Effective" column: tyba DoE = taxable years beginning after date of enactment
ppisa = property placed in service after
tyba = taxable years beginning after

[1] Because reliable macroeconomic forecasts are not available for years beyond 2000, estimates for fiscal years 2001 - 2005 should be considered less reliable.
[2] Loss of less than $50 million.
[3] Loss of less than $100 million.
[4] This line represents an adjustment to the revenue estimate which results when all of the capital gains provisions are estimated together as an entire package.
[5] Total represents sum of proposed changes in the tax law referred to the Committee on Ways and Means, but does not include effects of provisions referred to other committees.
[6] Total does not include possible interaction among the provisions of the four bills.