



The JCT Revenue Estimating Process

Joint Committee on Taxation

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Joint
Committee on
Taxation



Outline

- The Staff
- Baseline and Proposal Receipts Projections
- JCT Models
- Dynamic Microeconomic Estimates
- Quality Control
- Macroeconomic Analysis



JCT Revenue Estimating Staff (2010)

- 18 PhD economists specialize in the budget analysis of tax legislation,
 - With 10+ years average experience in this work.

- These economists work with staff tax lawyers, other PhD economists and accountants.

- JCT utilizes an interdisciplinary approach:
 - Every JCT revenue estimate is a joint product of the insights of the economic, legal and accounting professions;
 - Ensures that estimates accurately reflect proposed legislation and realistically model taxpayer behavioral responses.

- In 2009 the JCT revenue estimating staff processed approximately 7,000 revenue requests.



Revenue Estimate Request Process

- Any member of Congress may request a revenue estimate of proposals to modify the Internal Revenue Code.
- **All** requests are treated as confidential and are discussed only with the member's office.
- Official responses are confidential and are sent only to the requesting office.
- Members often ask for help in crafting their proposal so that statute language reflects the policy intent of the proposed legislation.



What is a JCT Revenue Estimate?

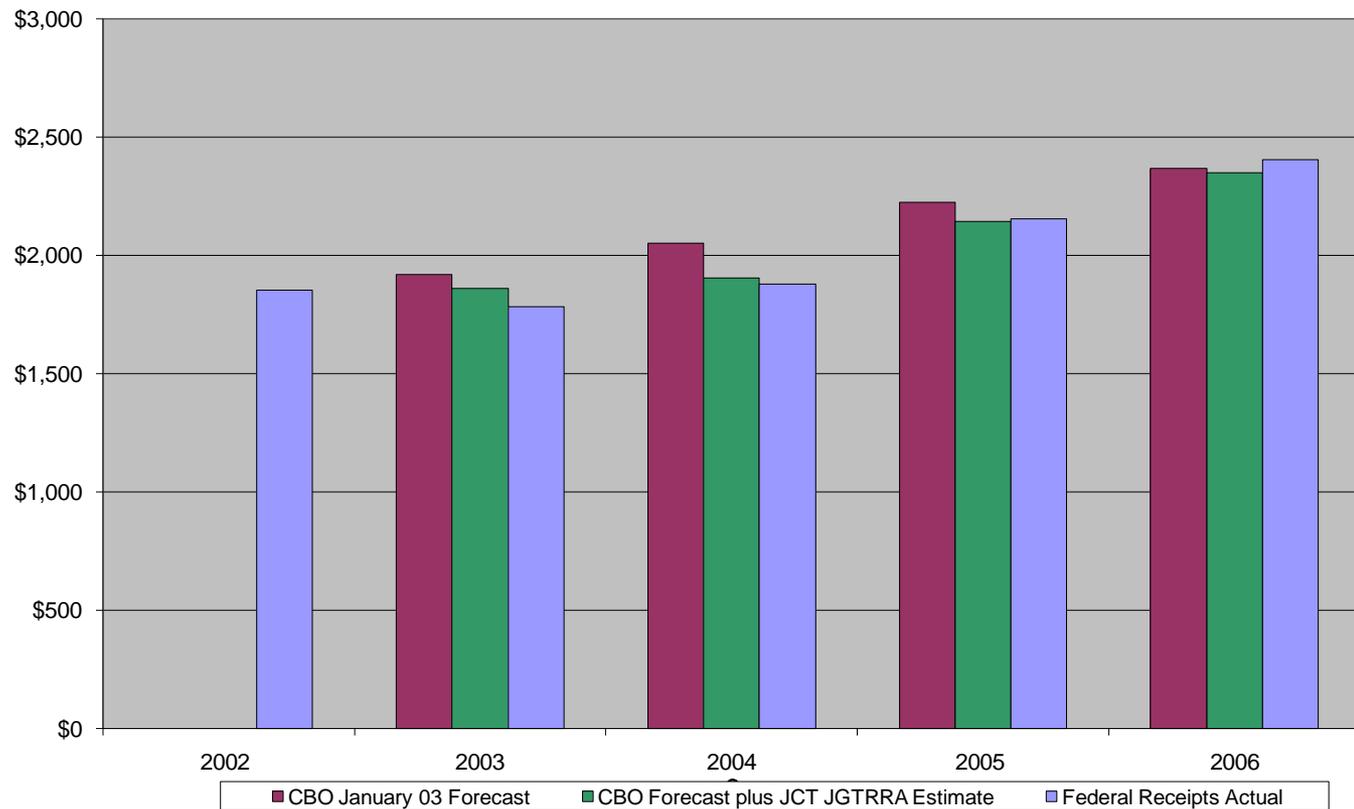
- A JCT revenue estimate compares *predicted* Federal revenues under the proposal with predicted revenues under present law:
 - Predicted future revenues under proposed new law (**proposal revenues**)
 - Less predicted future revenues under present law (**baseline revenues**)
 - Equals the revenue estimate.
- A year by year comparison is provided over the 10-year “budget window.”
- The distinction between current revenues and baseline revenues is important.
 - JCT estimates are comparisons with predictions of future revenues under present law, *not* current revenue levels.
- The receipts under a new proposal in a future year may be higher than at present, but *still lower than the forecasted present law receipts in that year.*
 - JCT would estimate such a proposal as losing revenue (less revenue than the baseline).



Simultaneous Revenue “Losses” and Higher Federal Receipts

- JCT estimated that the 2003 Act would “lose” revenue.
 - These losses were relative to baseline projections of growing receipts.
 - Projections of revenue losses were also a good prediction of increases in actual government receipts.

Fiscal Year Federal Receipts Current Dollars,
in Billions





The Revenue Baseline

- JCT begins with CBO's 10-year economic baseline.
 - CBO economic baseline predicts growth in economy and other long-term trends.

- JCT then refines CBO's economic baseline to create a detailed *revenue baseline*.
 - For example, CBO's estimate of wage growth combined with CBO employment forecast results in the OASDI wage base and its resulting payroll revenues.

- JCT revenue baseline forecasts taxpayer behavior under the present law tax code.
 - We *do not* predict future Congressional action.
 - We *do* assume that phase-ins and sunsets will occur as scheduled.



Change in Revenue Under Proposal

- Projecting revenues under proposed laws requires JCT to predict how receipts will change under those new laws.

- These projections are generally not linear extrapolations of historical data.
 - Historical data only describe taxpayer activity under prior law.
 - Taxpayers will behave differently under the proposed law.
 - Proposed new rules may interact with existing tax law.
 - *Example:* increasing the standard deduction will cause some itemizers to become non-itemizers.

- JCT relies on sophisticated *tax models* to predict expected future tax revenues resulting from enacting a tax proposal.



JCT Tax Models

- JCT tax models simulate future taxpayer behavior under the baseline and under the proposal.
- JCT uses many different models:
 - An individual tax model to forecast revenues from the individual income tax and from employment taxes;
 - A corporate model for the corporate income tax;
 - An estate and gift model for changes to inheritance and gift taxes;
 - Many different excise tax models;
 - And many smaller tax, credit, or exclusion specific models.
- Each model incorporates relevant taxpayer behavior, such as:
 - Changes in the timing of transactions and income recognition;
 - Changes between business sectors and among legal entities;
 - Changes in the types and timing of consumption and investment;
 - Tax planning and tax avoidance (or evasion) strategies.



Example: Individual Tax Model

- JCT's Individual Tax Model is a representation of all 163+ million U.S. tax filing units.
 - All categories of taxpayers;
 - For each of the 10 years in the budget window;
 - Taking into account projected economic, demographic and social trends.
- The Individual Tax Model uses a detailed representative sample of 336,000 actual 2007 income tax returns filed by U.S. taxpayers.
 - Uses Current Population Survey and other data to impute information not reported on tax returns.
 - Uses a representative sample of Information Returns (W2's, 1099-INTS, etc.) to impute information about tax filing units that did not file tax returns in 2007.
- Using these returns and CBO's baseline economic forecasts, the Individual Tax Model simulates the taxpayer population for each future year.
 - The Individual Tax Model adjusts the weights and income items for each sample tax record to match CBO's economic forecast.



The JCT Individual Tax Model and Behavior

- The Individual Tax Model first predicts which tax elections taxpayers will make in the future under the baseline and under the proposal, before accounting for changes in economic behavior.
 - *Example:* Individuals decide whether to itemize deductions, given effects of proposals.

- JCT economists then adjust the Individual Tax Model to account for more sophisticated taxpayer responses to proposed laws.



How Do JCT Tax Models Incorporate Taxpayer Behavior?

- Every JCT revenue estimate is a “dynamic” estimate.
 - *Our estimates reflect taxpayers’ predicted reactions to a new law.*
- JCT economists adjust each model to reflect the anticipated changes in supply or demand in response to proposed new tax rules.
 - *Example:* If a tax increase raises gas prices by \$0.50/gallon, how much will taxpayers adjust their consumption of gas?
 - JCT economists research answers to questions like this and incorporate them into each estimate.
- Predicting behavioral responses requires original research as well as JCT economists’ knowledge of the relevant economics literature.
- JCT lawyers help the economists to better understand the law and taxpayer planning or avoidance strategies.



The Result – A Dynamic Revenue Estimate

- Based on the conclusions of the economists' research, a revenue estimate might reflect changes in behavior such as:
 - Changes in the timing of transactions and income recognition.
 - *Example:* Realization of capital gains in response to changes in rates.
 - Changes between business sectors or the legal form of doing business.
 - *Example:* Organizing a partnership rather than a corporation.
 - Changes in types of portfolio investments
 - *Example:* Sell bonds and buy stock to obtain 15% dividends rate.
 - Changes in the amount, types, and timing of consumption.
 - *Example:* Response to changes in tax exclusion for employer-provided health insurance.
 - Tax planning and tax avoidance (or evasion) strategies.
- Consistent with economic theory, JCT tax models assume that taxpayers will largely behave rationally, while taking into account other behaviors as implicated by data and recent research.



Dynamic Analysis Example

- **Estimating the Revenue Effect of a Tobacco Excise Tax Increase:**
 - JCT starts with the CBO tobacco excise tax baseline.
 - JCT expands that data to encompass the detail required to estimate the proposal.
 - JCT economists research price elasticities of cigarette smoking in the range contemplated by the new tax increase.
 - JCT economists modify the excise tax model to reflect our conclusions on how smokers will respond to these higher prices:
 - Some potential smokers will never start;
 - Some smokers will decide to quit;
 - Some smokers will reduce the amount they smoke.
 - *Example:* JCT estimated that the changes made in 2007 to raise the tobacco excise tax by \$0.61/pack would result in 2 billion fewer cigarettes sold annually.
 - Our revenue estimate reflected this smaller tax base.

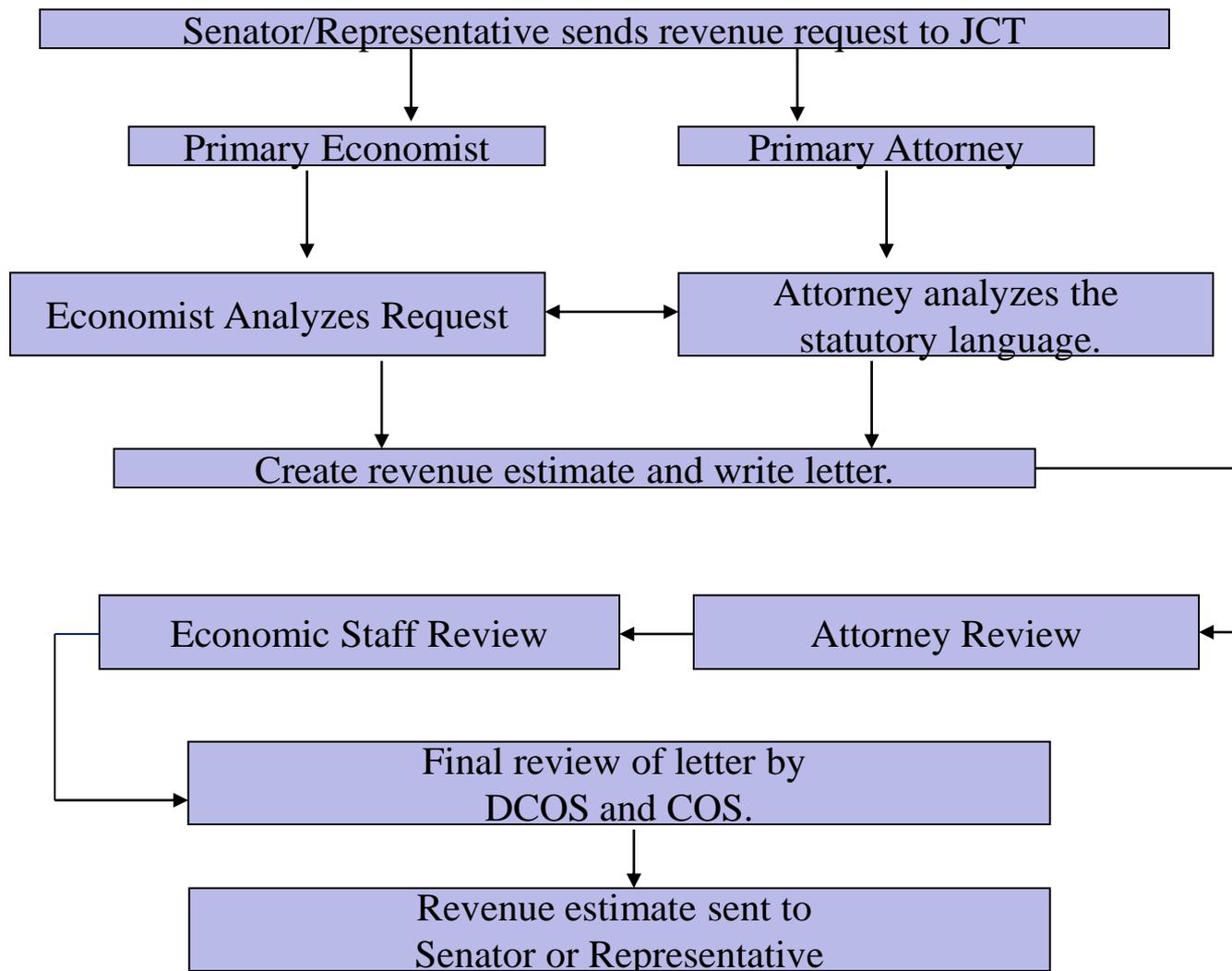


Dynamic Analysis Example

- **Estimating the Revenue Effect of Capping the Exclusion on Employer Paid Health Insurance:**
 - Employer paid health insurance is currently nontaxable and does not show up on tax returns.
 - JCT uses data from a variety of sources to statistically impute insurance coverage and premium values to each taxpayer.
 - JCT calculates the effect of the exclusion cap on the after-tax price of health insurance for each taxpayer on the model.
 - JCT predicts the effects of changes in healthcare prices on insurance coverage and wage levels using elasticities from the economics literature.
 - Revenue estimate reflects projected changes in taxable income after taking into account the cap amount and behavioral changes.



JCT Quality Control and Process





Macroeconomic Analysis

- A standard JCT estimate incorporates behavioral responses in projecting tax revenues, but assumes that these tax and behavioral changes do not change the size of the US economy.
- **Fixed Gross National Product Constraint:**
 - Generally assumes that total labor supply and investment are fixed;
 - Does not assume that a surtax on labor income will cause taxpayers to retire early or work less;
 - Allows for shifts in investment to tax favored industries or jobs, but overall level of investment stays the same.
- On certain occasions, JCT will provide macroeconomic analysis of a bill that examines potential changes in GNP from a new policy.
 - Analyses are provided to comply with clause 3(h)(2) of rule XIII of the House Rules.
 - The rule requires JCT to provide a macroeconomic analysis for any bill or joint resolution reported by the Committee on Ways and Means.
 - JCT occasionally provides macroeconomic analyses of major policy initiatives at the request of Members.
 - Some of these analyses can be found at <http://www.jct.gov/publications.html> under “Macroeconomics”.



Further References on the JCT Estimating Process

- **JCX-1-05**: Overview Of Revenue Estimating Procedures And Methodologies Used By The Staff Of The Joint Committee On Taxation
- **JCX-101-07**: Modeling the Federal Revenue Effects of Proposed Changes in Cigarette Excise Taxes
- **JCX-17-07**: Estimating The Revenue Effects Of The Administration's Fiscal Year 2008 Proposal Providing A Standard Deduction For Health Insurance: Modeling And Assumptions
- **JCX-36-02**: Written Testimony Of The Staff Of The Joint Committee On Taxation At A Hearing Of The Subcommittee On Oversight Of The House Committee On Ways And Means Concerning Modeling The Economic Effects Of Changes In Tax Policy