Clinton Proposes Massive Tax Increases
New Energy Tax to Hit Low and Middle Income Families

President Bill Clinton in his address to the Congress presented the nation with massive tax increases — a net increase of $245 billion over 5 years. This comes at a time when American taxpayers are already shouldering the heaviest tax burden in U.S. history.

The biggest departure from current tax policy is the proposal of a broad-based energy tax based on British thermal units, or BTUs. (A BTU measures the quantity of heat needed to increase the temperature of one pound of water by one degree Fahrenheit when water is at or near 39.2 degrees. Different forms of energy have different costs to consumers per BTU. BTUs are a convenient way to determine a tax base across sources of energy that would otherwise be difficult to compare.)

The BTU tax is slated to raise over $71 billion between 1994 and 1998. The true burden from a BTU tax is generally hidden from consumers and investors. Therefore, once introduced, it will likely prove very easy to increase further in the future. The greatest risk from a BTU tax, therefore, may be from future tax increases.

The table at the right shows the breakdown of the tax burden, by household income, stemming from a BTU tax. Lower-income households clearly bear a proportionally greater burden from this tax.

<table>
<thead>
<tr>
<th>Family Income</th>
<th>Average Annual BTU Tax as a % of Income</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than $10,000</td>
<td>1.72%</td>
</tr>
<tr>
<td>10,000 - 20,000</td>
<td>0.93</td>
</tr>
<tr>
<td>20,000 - 30,000</td>
<td>0.71</td>
</tr>
<tr>
<td>30,000 - 40,000</td>
<td>0.56</td>
</tr>
<tr>
<td>40,000 - 50,000</td>
<td>0.49</td>
</tr>
<tr>
<td>More than $50,000</td>
<td>0.32</td>
</tr>
</tbody>
</table>

Source: Consumer expenditure survey data and Tax Foundation computations.

The BTU tax will cause a regional imbalance as well because energy consumption varies across the country. According to Department of Energy data, residents of western south central states will pay twice as much as taxpayers in most other areas of the country.

One-Two Punch?

Only the Tax Equity and Fiscal Responsibility Act of 1982 (TEFRA) is comparable in size to the Clinton Plan. However, TEFRA had the virtue of coming on the heels of the Economic Recovery Tax Act of 1981 (ERTA), by far the largest tax reduction in U.S. history. ERTA cut taxes 11.6%
Consumers react to high state sales and excise taxes by crossing state lines in large numbers to shop where rates are lower, according to new research from the Tax Foundation. Titled The Effects of Cross-Border Sales on Economic Activity and State Revenues: A Case Study of Tobacco Excise Taxes in Massachusetts, the study examines consumer behavior in the border counties of states that have raised or proposed raising their cigarette taxes. The Tax Foundation-sponsored study investigates the dynamics of interstate tax competition by estimating the importance of cigarette excise tax differentials on cross-border shopping and smuggling. Cigarettes were chosen because of the wide tax differentials across states and the quality and availability of data on cigarette consumption.

Specifically, the study consists of two case studies of the economic and tax revenue effects of raising the cigarette excise tax. The first focuses on changes in the states bordering Massachusetts which raised its cigarette excise from 26 to 51 cents per pack on January 1, 1993.

In a local focus, the second case study considers a proposed cigarette tax hike in New York City from 8 to 13 cents above and beyond the state rate. The New England area was chosen for case study because of the large percentages of the state populations within easy driving distance of other states, and because of recent cigarette tax legislation and proposals.

**Massachusetts**

By almost doubling its cigarette excise tax from 26 to 51 cents per pack on January 1, 1993, the Massachusetts state government cannot expect to double its revenue. Some consumers will cut back their purchases and many will flock to nearby states to buy cigarettes, so that Massachusetts can expect to receive less new revenue than simple static projections would indicate.

States surrounding Massachusetts can expect a tax revenue windfall as their lower cigarette excise rates attract buyers from Massachusetts. Due to cross-border shopping, New Hampshire will reap an additional $19.95 million annually; Vermont $1.42 million; Connecticut $10.4 million; Rhode Island $10.5 million; and New York $0.8 million.

**Surrounding States**

If New Hampshire attempted to double its cigarette excise tax from 25 to 50 cents per pack, it could expect to collect an additional $27.4 million, only $7.45 million more than by sticking with its current tax level and reaping the benefits of Massachusetts shoppers crossing over the border. However, any tax hike would widen the tax differential with Vermont, and result in lost revenue along the long Vermont border.

**New York City**

The case study of New York City's cigarette taxes shows the bulk of lost New York City sales going to New Jersey where the rate is 40 cents per pack. The city also loses substantial sales and revenue to the lower-tax counties of Nassau and Westchester. These losses will increase if New York City raises its cigarette tax, and will dramatically increase if New York State increases its cigarette excise tax from 39 to 60 cents per pack, as suggested by the governor's budget proposal. Such a large state increase would also dramatically widen the tax differentials between New York and Pennsylvania (31 cents) and Vermont (20 cents).
Clinton Tax Plan

Continued from Page 1

percent of GDP, or $589 billion in today’s dollars, in its first four years.

Clinton’s tax hikes would have no such luxury. Rather, they would overlap with the major tax increases enacted in 1990.

The average American taxpayer worked 126 days in 1992 to pay for government, longer than in any previous year, and didn’t celebrate “Tax Freedom Day” until May 5. Enactment of such large tax increases will only postpone Tax Freedom Day in years to come.

Major Tax Provisions

**Individuals**
- Energy tax on BTUs.
- 36% tax rate bracket for taxable incomes over $140,000 (joint returns) and $115,000 (singles).
- 10% surtax on regular taxable incomes over $250,000.
- Percentage of Social Security benefits subject to tax increased from 50% to 85%.
- Eliminate wage cap on tax for Medicare.
- Increase in personal alternative minimum tax rate to 26% for alternative minimum tax income of less than $175,000 and 28% over $175,000.

**Corporations**
- 36% corporate tax rate on income over $10 million.
- Tougher compliance rules for foreign corporations.

**Targeted Tax Relief**
- Temporary incremental tax credit for large businesses and permanent investment tax credit for businesses with gross receipts under $5 million.
- New incentives for investment in small businesses.
- Alternative minimum tax depreciation relief.
- Passive activity loss relief for real estate.
- Permanent extension of targeted jobs tax credit, research and experimentation tax credit, and low-income housing tax credit.
- Enterprise zone tax incentives.
- Expanded earned income tax credit for lower-income wage earners.

New Foundation Report Traces Gasoline Excise Tax Collections

Poor, Middle-Class, and Rural Americans Pay the Most

A new Tax Foundation Special Report describes the rapidly increasing taxes Americans pay for gasoline. The average gas tax, federal and state combined, has more than doubled from 14 cents per gallon in 1982 to 32.6 cents in 1992.

Titled *The Price of Mobility: Gasoline Taxes in America*, the study analyzes current federal and state gasoline tax burdens on individuals over a range of income brackets and concludes that the gasoline tax hits poor and middle-income Americans the hardest (see bar chart).

Rural states absorb a disproportionately large share of the gas tax, according to the report. For example, Wyoming residents pay about $90 annually per capita in federal gas taxes because the state has both a high driver/population ratio and high annual mileage per driver. By contrast, residents of the District of Columbia pay $38 per capita annually.

The report, authored by Tax Foundation economist Chris R. Edwards, also traces how the receipts are parceled out to various special funds at the federal, state and local levels.

Estimates vary on the impact of the gas tax on business, but in a 1991 study, the U.S. Department of Energy estimated that a 50-cent per gallon increase in the gasoline tax would reduce gross national product (GNP) by $57 billion per year while only increasing government revenues by $34 billion.

Every state levies a state gasoline tax, in addition to levying excise taxes on diesel and other fuels. From 1982 to 1992, the average state gasoline tax rate has more than doubled from 9.1 cents per gallon to 18.5 cents per gallon. State gas tax rates currently range from 8 cents per gallon in Alaska to 26 cents per gallon in Rhode Island.

Further increases in state motor fuel taxes are expected in 1993, following increases in FY '92 that netted an additional $459 million for state governments on top of $716 million in new revenue in FY '91. In recent legislative action, California, Oregon, Connecticut, and Florida started 1993 with a motor fuel tax increase effective January 1st.

In FY '92 the federal government raised approximately $15 billion from the 14.1 cent federal gasoline tax, while state governments collected approximately $21 billion. This works out to $206 per driver in 1992.

Eleven states can now increase motor fuel taxes without legislation. For example, under these procedures, the Nebraska Department of Revenue increased that state's gasoline tax from 24 to 24.6 cents per gallon for the first quarter of 1993.
It's Time to Simplify the Nation's Tax Laws

Dan Rostenkowski
Chairman
House Committee on Ways & Means

The Tax Simplification Act of 1993, which I recently introduced, would simplify more than 100 different provisions of the tax laws, including provisions related to the earned income tax credit, intangible assets, pensions, individuals, partnerships, international taxation, tax-exempt bonds, estates and gifts, and a wide variety of other tax provisions.

I believe that the time for enactment of this bill is long overdue. All of the bill's provisions passed the House in the 102nd Congress. In addition, most of the provisions were included last year in both H.R. 4210 and H.R. 11 — the two major tax bills that were vetoed by President Bush.

All of the bill's simplification provisions are the product of a major tax simplification initiative that I announced three years ago. In February 1990, I requested the interested public, tax professionals, the Secretary of the Treasury, and the congressional tax-writing staffs to develop tax simplification proposals that would make life easier for the taxpaying public, return preparers, tax administrators, and the courts, without undoing major policy objectives or increasing the deficit. In response to that request, I received hundreds of proposals that eventually were publicized in an 1,100-page Ways and Means Committee publication.

At my direction, these simplification proposals were thoroughly analyzed by the congressional tax-writing staffs, with the cooperation of the Treasury Department and the Internal Revenue Service. In 1991, I introduced several bills reflecting their collective recommendations regarding these various proposals. Subsequently, the Ways and Means Committee and the Subcommittee on Select Revenue Measures held public hearings on these bills. The vast majority of the provisions contained in this bill were reported favorably by the Committee on Ways and Means in the 102nd Congress.

The bill that I have introduced in the 103rd Congress generally mirrors the simplification provisions that were contained in the conference agreement to H.R. 11. Since their initial introduction some two years ago, these provisions have been fine-tuned through the legislative process of hearings, Committee action, and conference action. However, I continue to remain open to consideration of further improvements to these provisions.

In particular, one of the most significant provisions of this bill would simplify the tax treatment of acquired intangible assets by assigning them a uniform 14-year life. There is widespread agreement that this provision would eliminate a major source of uncertainty and controversy in the tax laws.

FRONT & CENTER
and end-all of tax simplification. Rather, they are an important first step in what for me is a long-term commitment to simplify the tax laws. I am heartened by the progress that this legislation reflects and by the support that it has garnered. It has been questioned whether there is any constituency for tax simplification that does not represent tax relief for specific industries. This legislation proves that there is a constituency for broad-based tax simplification. In the 103rd Congress, I will continue to solicit proposals to simplify the tax code with the hope of producing additional legislation to accomplish that goal.

In addition to the simplification legislation, I have also introduced a technical corrections bill and, along with Congressman Rangel, legislation to extend permanently the low-income housing credit.

The low-income housing credit has played a critical role in the development of affordable housing for our nation's low-income individuals. By providing an incentive to spur the production of housing for these individuals, the credit has played an invaluable role in improving the quality of life for people who otherwise may have found it impossible to find decent affordable housing.

Unfortunately, the low-income housing tax credit expired for periods after June 30, 1992. Last year, we passed legislation on two occasions (H.R. 4210 and H.R. 11) that would, among other things, have extended the credit permanently. However, President Bush vetoed these bills, leaving the future of the housing credit in jeopardy.

I am optimistic that President Clinton will recognize the importance of the credit in developing affordable housing for our nation's low-income families, and that we can make the credit permanent this year as part of any comprehensive legislation to assist cities and stimulate investment and economic growth. I will, of course, work with the new Administration as it crafts its economic proposals and will remain flexible in fashioning the best comprehensive economic program for the nation. In that context, it may also be appropriate to extend other meritorious tax incentives that have now expired.

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Income Tax Treatment of Intangible Assets

One of the more significant provisions of H.R. 13, as introduced by Chairman Rostenkowski, relates to the amortization of goodwill and certain other intangible assets. Present law allows depreciation or amortization deductions for the cost or other basis of intangible property that is used in a trade or business or held for the production of income if the property has a limited useful life that may be determined with reasonable accuracy. However, neither goodwill nor "going concern value" may be depreciated or amortized under present law.

The proper tax treatment of the costs of acquiring intangible assets is a major source of controversy between taxpayers and the IRS. The disputes that arise generally involve three broad issue areas: (1) whether an amortizable intangible asset exists; (2) the portion of the purchase price of a trade or business that is allocable to an amortizable intangible asset; and (3) the proper method and period for recovering the cost of an amortizable intangible asset.

Under section 501 of H.R. 13, the cost of most acquired intangible assets, including goodwill and going concern value, would be amortized ratably over a 14-year period. By specifying a single method and recovery period for most acquired intangible assets, the bill is intended to alleviate many of the controversies that arise under present law with respect to acquired intangible assets. The 14-year recovery period was chosen because it would result in relative revenue neutrality over the next five fiscal years.

Intangible assets covered by the bill's provisions would include: (1) goodwill and going concern value; (2) items related to workforce, information base, know-how, customers, suppliers, etc.; (3) licenses, permits, or other rights granted by a governmental unit; (4) covenants not to compete entered into in connection with the acquisition of a trade or business; and (5) franchises, trademarks, or trade names.

The 14-year amortization provisions generally would apply to intangible property acquired after the bill's date of enactment. However, taxpayers could elect to have the provision apply to all property acquired after July 25, 1991.

Editor's Note:
President Clinton has included the permanent extension of the Low-Income Housing Credit in his economic proposals.
New Faces at the Ways and Means, and Finance Committees

The House Committee on Ways and Means has expanded in size from 36 to 38 members in the 103rd Congress, with 15 new members — 10 Democrats and 5 Republicans.

Gerald Kleczka (D-WI) is regarded as having budget expertise; John Lewis (D-GA) has established himself as part of the Democratic leadership team, having served as a chief deputy whip since the last Congress; Lewis Payne (D-VA), a former developer, spent the last Congress on the Budget Committee; Richard Neal (D-MA) comes from the House Banking Committee where his major concern was the credit crunch; Peter Hoagland (D-NE), also from the Banking Committee, has been concerned with restrictive bank lending practices; Michael McNulty (D-NY) gave up his seat on the Armed Services Committee to join Ways and Means; Michael Kopetski (D-OR) has served as a House Democratic whip; William Jefferson’s (D-LA) primary interests are health, welfare, and jobs; William Brewster (D-OK) is interested in matters relating to oil and gas, as well as health care; Mel Reynolds (D-IL) is the only freshman Member of Congress to gain a seat on the committee.

Amo Houghton (R-NY), a former member of the Budget Committee, is the first former Fortune 500 executive (Corning Glass) to sit on the Committee; Wally Herger (R-CA) brings a solidly conservative background to the committee; Jim McCrery (R-LA) is a former city attorney; Mel Hancock (R-MO) led a successful anti-tax initiative before coming to Congress and consistently votes against appropriations bills; and Rick Santorum (R-PA), a former tax lawyer, introduced several anti-spending bills last year as a member of the Budget Committee.

Only one of the six Ways and Means subcommittees has a new chairman for the 103rd Congress. Robert Matsui is the chairman of the Human Resources Subcommittee. The other subcommittee chairmen are Sam Gibbons (Trade), Pete Stark (Health), J.J. Pickle (Oversight), Charles Rangel (Select Revenue Measures), and Andy Jacobs (Social Security).

On the Senate Finance Committee, Steve Symms (R-ID) will be replaced by Malcolm Wallop (R-WY) whose subcommittee assignments are International Trade; Energy and Agricultural Taxation; and Deficits, Debt Management, and International Debt (Ranking Minority Member). The departure of Lloyd Bentsen for the Treasury Department moved Daniel Patrick Moynihan to chairman and left room for Kent Conrad (D-ND) who has Budget Committee experience and was a state tax commissioner before his election to the Senate in 1986.
The Tax Foundation is pleased to announce that JD Foster has joined the staff as chief economist and director. He will oversee research programs and development efforts.

Before joining the Tax Foundation, he spent a year as Special Assistant to the Chairman of the President's Council of Economic Advisers under Michael Boskin. Previously, he was simultaneously staff economist with the Senate Republican Policy Committee and economic counsel to Senator Steve Symms (R-ID) where he oversaw the Senator's Finance and Budget Committee responsibilities. Prior to joining Senator Symms and the Policy Committee, he was economic counsel for Senate Finance Committee Senator William Armstrong (R-CO), and before that he spent three years at the Institute for Research on the Economics of Taxation.

He received his B.A. in Economics and Applied Mathematics from the University of Colorado, an M.A. in Economics from Brown University, and a Ph.D. in Economics from Georgetown University.
As the transition from the Bush Administration to the Clinton Administration was nearing completion, the Treasury Department released a comprehensive plan for tax reform titled, "An Option for Fundamental Reform." According to its framers, the plan represents an alternative to the current federal tax system that is both revenue-neutral and distributionally neutral. The plan was designed with the following three objectives in mind: (1) generate a substantial increase in private sector saving and investment, (2) materially advance our competitive position in the world economy, and (3) dramatically reduce taxpayer burdens and administrative costs.

Under the tax reform plan, more than 50 percent of all individual taxpayers would no longer be subject to the income tax. Moreover, the tax law for business taxpayers would be radically simplified.

In order to reduce distortions of private savings and investment decisions, the plan would eliminate the double taxation of corporate profits, repeal the corporate alternative minimum tax, and reform the rules for taxing multinational business activities.

The plan is intended to achieve a substantial reduction in the government’s reliance on income tax revenues through enactment of a border-adjusted business transfer tax, with exemptions for small business. The base for the business transfer tax would be sales less purchases from other firms.

More specifically, "An Option for Fundamental Reform" suggests the following changes in tax law:

- The individual income tax standard deduction would be increased to a level that would exempt more than half of all individual taxpayers from the income tax. (For married couples filing joint returns, the standard deduction would be $33,800.)
- The corporate and individual income tax system would be integrated through a dividend exclusion regime. In general, a corporation would compute its taxable income and pay tax as under current law. A distribution out of a corporation’s after-tax income, after making certain limited adjustments, would be treated as a dividend and would be excludable from gross income when received by a shareholder.
- The corporate alternative minimum tax would be repealed. In addition, business preferences would be removed from the base for the individual alternative minimum tax.
- The rules for taxing multinational business activities would be simplified and reformed. While not yet embracing a specific reform option, the plan suggests adoption of a modified exemption system that does not impose U.S. tax on active foreign-source income, adoption of a regime of current taxation of foreign-source income, or modification of the current system in less radical ways.
- The federal government would impose a broad-based consumption tax at a single rate, with the tax administered as a Business Transfer Tax (BTT). The base for the BTT would be all domestic sales by businesses, less purchases from other businesses. The BTT would be fully border-adjustable (i.e., the full tax would be imposed on imports, and all tax would be removed from exports). Small businesses would be exempt from the BTT, and low-income families would receive a refundable BTT credit to effectively negate the new tax.