TAX FOUNDATION

SPECIAL REPORT

March 1995
Number 46

Analysis and Summary of the "Contract With America Tax Relief Act of 1995"

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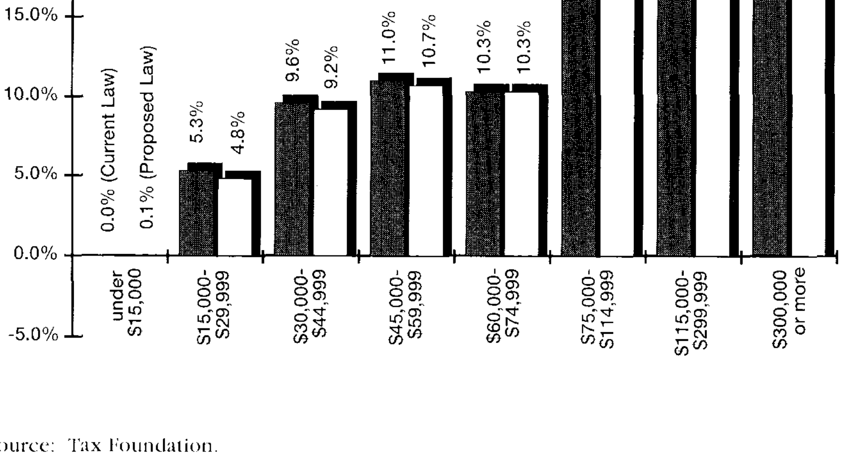
The tax provisions in the "Contract With America," if enacted, will reduce Americans' tax burden by an estimated $188.8 billion over the five-year budget period from 1995 to 2000. At the same time, the provisions will slightly increase the share of the income tax burden borne by those taxpayers with $75,000 or more of adjusted gross income, as *Figure 1* and *Table 1* demonstrate.

Figure 1
Share of Individual Income Taxes Under Current Law and Proposed "Contract" Provisions, by Income Class, 1995-2000



Source: Tax Foundation.

Table 2 reports estimates of how the Contract's tax reductions will be distributed across different income groups. The estimated average tax reduction for all income tax filers amounts to $1,552 over the 1995 to 2000 time period. The only provision estimated to expose more taxpayer income to taxation is the American Dream Savings Account (ADSA). The assumption is that taxpayers will forego tax deductible contributions to other retirement-type accounts in order to make non-deductible contributions to an ADS account that permits tax-free money growth and tax-free withdrawals for specified expenditures like college tuition. In *Table 2*, the revenues raised from the ADS accounts offset the $500 million in estimated tax relief provided by the spousal IRA provision.

Table 3 distributes the Contract's tax reduction across the different states. *Table 4* and *Figure 2* show the net tax savings per income tax filer in each state. Connecticut, New Jersey, New York, California, and Massachusetts rank as the top five states in terms of per-filer tax savings. (The District of Columbia would rank fourth if it were a state.) Alabama, Alaska, Mississippi, South Dakota, and North Dakota rank as the bottom five states in terms of per-filer savings.

In what follows, the key provisions of the "Contract with America Tax Relief Act of 1995" are described and summarized. *Figure 3* illustrates how the net tax reduction measures are divided among the various titles of the Act.

Table 1
Comparison of Tax Distribution under Current Law and "Contract With America," 1995-2000

Income (AGI) Group	Millions of Current Dollars: Distribution of Individual Income Taxes Under Current Law	Millions of Current Dollars: Distribution of Individual Income Taxes After "Contract" Provisions	Share of Individual Income Taxes Under Current Law	Share of Individual Income Taxes After "Contract" Provisions
under $15,000	-1,274	-2,872	-0.03%	-0.08%
$15,000-$29,999	210,592	184,949	5.25	4.84
$30,000-$44,999	385,926	353,104	9.63	9.24
$45,000-$59,999	440,569	407,618	10.99	10.67
$60,000-$74,999	414,565	394,787	10.34	10.33
$75,000-$114,999	702,748	674,713	17.53	17.66
$115,000-$299,999	763,225	743,170	19.04	19.45
$300,000 or more	1,092,187	1,065,660	27.25	27.89
Total	4,008,539	3,821,129	100.00	100.00

Note: The negative tax liability results from the Earned Income Tax Credit.
Source: Tax Foundation.

Table 2
The Distribution of Tax Reduction Provisions in the "Contract With America," 1995-2000
(Millions of Current Dollars, Except Per Filer)

	American Dream Restoration				Job Creation and Wage Enhancement		Family Reinforcement			
Income (AGI) Group	Family Tax Credit	Marriage Penalty Credit	ADSA & Spousal IRA	Senior Citizens Tax Reforms	Individual Capital Gains Reforms	Small Business Tax Reforms	Adoption Credit	Custodial Care Credit	Total Reduction Due to "Contract" Provisions*	Avg. Reduction PerTax Filer
under $15,000	$-1,037	$0	$99	$-229	$-68	$0	$-187	$-176	$-1,598	$-44
$15,000 under $30,000	-22,278	0	365	-1,926	-176	-1,088	-278	-263	-25,643	-914
$30,000 under $45,000	-24,456	0	331	-6,634	-541	-1,143	-195	-184	-32,822	-1,775
$45,000 under $60,000	-23,502	-710	183	-7,273	-339	-1,039	-140	-132	-32,951	-2,503
$60,000 under $75,000	-11,458	-1,626	126	-5,080	-567	-984	-96	-91	-19,778	-2,174
$75,000 under $115,000	-16,199	-2,409	203	-5,505	-1,942	-1,982	-104	-98	-28,035	-2,860
$115,000 under $300,000	-5,970	-1,942	160	-2,637	-5,773	-3,846	0	-47	-20,055	-4,238
$300,000 or more	0	-1,505	33	-451	-19,275	-5,321	0	-8	-26,527	-33,220
Total	$-104,900	$-8,191	$1,500	$-29,735	$-28,681	$-15,403	$-1,000	$-1,000	$-187,410	$-1,552

* The $1.4 billion difference between the Tax Foundation's estimated total tax reduction of $187.4 billion and the official total of $188.8 billion results from small differences in estimation. In addition, corporate tax reform provisions were excluded because the net revenue loss associated with these reforms amounted to less than $1 billion over the 1995-2000 budget period.
Source: Tax Foundation.

American Dream Restoration Tax Act

Family Tax Credit

This provision provides for a nonrefundable $500 tax credit for each child under the age of 18. (Nonrefundable means that the credit cannot be used to create a "negative" tax, that is, a positive net payment from the Treasury to the taxpayers.) The value of the credit begins to phase out for taxpayers with $200,000 of adjusted gross income. Taxpayers with AGI of $250,000 or more receive no tax credit. The phaseout works by applying a phaseout ratio to the credits. The ratio is created by dividing the amount of AGI in excess of $200,000 by $50,000. For example, a taxpayer that reported $225,000 in AGI and had two qualifying children would receive half of the allowable credits ($25,000/$50,000). Both the credit and the phaseout range will be indexed for inflation after calendar 1996.

Table 3
State-by-State Distribution of the Tax Reduction Provisions in the "Contract With America," 1995-2000
(Millions of Current Dollars)

	American Dream Restoration				Job Creation and Wage Enhancement		Family Reinforcement		
State	Family Tax Credit	Marriage Penalty Credit	ADSA & Spousal IRA	Senior Citizens Tax Reforms	Individual Capital Gains Reforms	Small Business Tax Reforms	Adoption Credit	Custodial Care Credit	Total
Alabama	-$1,440	-$92	$21	-$36	-$225	-$178	-$15	-$14	-$1,979
Alaska	-248	-23	3	-92	-24	-45	-3	-3	-433
Arizona	-1,424	-99	20	-418	-398	-185	-14	-14	-2,533
Arkansas	-789	-42	11	-257	-147	-79	-8	-8	-1,320
California	-12,848	-1,148	184	-3,572	-5,310	-2,144	-118	-120	-25,076
Colorado	-1,436	-106	19	-410	-346	-202	-14	-14	-2,508
Connecticut	-1,784	-192	27	-460	-697	-376	-15	-16	-3,513
Delaware	-315	-25	4	-87	-75	-49	-3	-3	-553
Dist. of Col.	-321	-26	5	-89	-148	-46	-3	-3	-630
Florida	-5,309	-404	79	-1,587	-2,126	-662	-52	-52	-10,112
Georgia	-2,575	-191	37	-753	-638	-381	-25	-25	-4,551
Hawaii	-505	-37	7	-143	-200	-69	-5	-5	-956
Idaho	-351	-20	5	-108	-72	-35	-4	-3	-589
Illinois	-5,093	-433	74	-1,427	-1,338	-820	-47	-48	-9,133
Indiana	-2,311	-159	32	-670	-328	-300	-22	-22	-3,779
Iowa	-1,120	-68	15	-337	-166	-119	-11	-11	-1,819
Kansas	-1,029	-73	14	-296	-234	-130	-10	-10	-1,767
Kentucky	-1,285	-79	18	-402	-223	-148	-13	-13	-2,145
Louisiana	-1,389	-89	20	-446	-158	-170	-14	-14	-2,260
Maine	-524	-31	7	-154	-142	-56	-5	-5	-911
Maryland	-2,369	-211	34	-624	-667	-413	-21	-21	-4,293
Massachusetts	-3,068	-266	44	-812	-971	-512	-27	-28	-5,641
Michigan	-3,964	-324	56	-1,115	-599	-646	-37	-37	-6,665
Minnesota	-1,908	-144	26	-537	-454	-274	-18	-18	-3,326
Mississippi	-778	-41	11	-267	-99	-80	-9	-8	-1,271
Missouri	-2,071	-145	29	-611	-371	-272	-20	-20	-3,481
Montana	-287	-16	4	-94	-59	-25	-3	-3	-482
Nebraska	-643	-40	9	-195	-110	-69	-6	-6	-1,061
Nevada	-529	-41	8	-148	-222	-69	-6	-5	-1,013
New Hampshire	-571	-47	8	-151	-192	-88	-5	-5	-1,051
New Jersey	-4,167	-409	62	-1,101	-1,422	-814	-37	-38	-7,926
New Mexico	-529	-31	7	-171	-100	-59	-6	-5	-895
New York	-8,087	-759	122	-2,214	-3,417	-1,409	-74	-75	-15,914
North Carolina	-2,674	-172	38	-805	-659	-332	-27	-26	-4,657
North Dakota	-243	-13	3	-77	-30	-22	-3	-2	-386
Ohio	-4,667	-317	66	-1,349	-768	-610	-45	-45	-7,734
Oklahoma	-1,137	-71	15	-347	-160	-130	-11	-11	-1,852
Oregon	-1,149	-75	16	-343	-278	-132	-11	-11	-1,983
Pennsylvania	-5,152	-372	74	-1,488	-1,033	-689	-50	-49	-8,758
Rhode Island	-463	-34	7	-130	-144	-63	-4	-4	-836
South Carolina	-1,307	-77	19	-402	-236	-152	-13	-13	-2,182
South Dakota	-251	-13	3	-82	-41	-21	-3	-3	-409
Tennessee	-1,878	-122	27	-576	-382	-238	-19	-19	-3,206
Texas	-6,323	-485	88	-1,924	-1,285	-916	-63	-62	-10,969
Utah	-594	-39	8	-174	-92	-71	-6	-6	-975
Vermont	-248	-16	3	-72	-86	-29	-2	-2	-452
Virginia	-2,796	-230	40	-762	-738	-446	-25	-26	-4,984
Washington	-2,103	-153	29	-585	-440	-279	-20	-20	-3,571
West Virginia	-606	-34	9	-187	-75	-64	-6	-6	-970
Wisconsin	-2,053	-142	29	-596	-521	-265	-20	-20	-3,589
Wyoming	-185	-13	2	-55	-34	-21	-2	-2	-309
United States	-$104,900	-$8,191	$1,500	-$29,735	-$28,681	-$15,403	-$1,000	-$1,000	-$187,410

Note: Corporate tax reform provisions were excluded because the net revenue loss associated with these reforms amounted to less than $1 billion over the 1995-2000 budget period.

Source: Tax Foundation.

Credit to Reduce Marriage Penalty

Married couples that earn a duel income and file a joint tax return often face a greater income tax liability than they would if they were unmarried and filed a single tax return. Under the Contract proposal, married couples could compare their tax liabilities with a published table of an array of hypothetical single-filer scenarios. If a couple's tax liability exceeded that of their comparable single-filer scenario, they would be eligible for a nonrefundable tax credit equal to the lesser of the excess liability or $145, with amounts less than $145 being rounded to the nearest $25.

American Dream Savings Accounts and Spousal IRA

The ADSA is a special type of savings account that would allow taxpayers to make annual, nondeductible deposits up to $2,000 or the taxpayer's entire income, whichever is the lesser amount. The investment would grow tax free and the taxpayer could make tax-free withdraws for specified purposes — generally, first-time home purchase, expenses for higher education, medical expenses and long-term care insurance premiums.

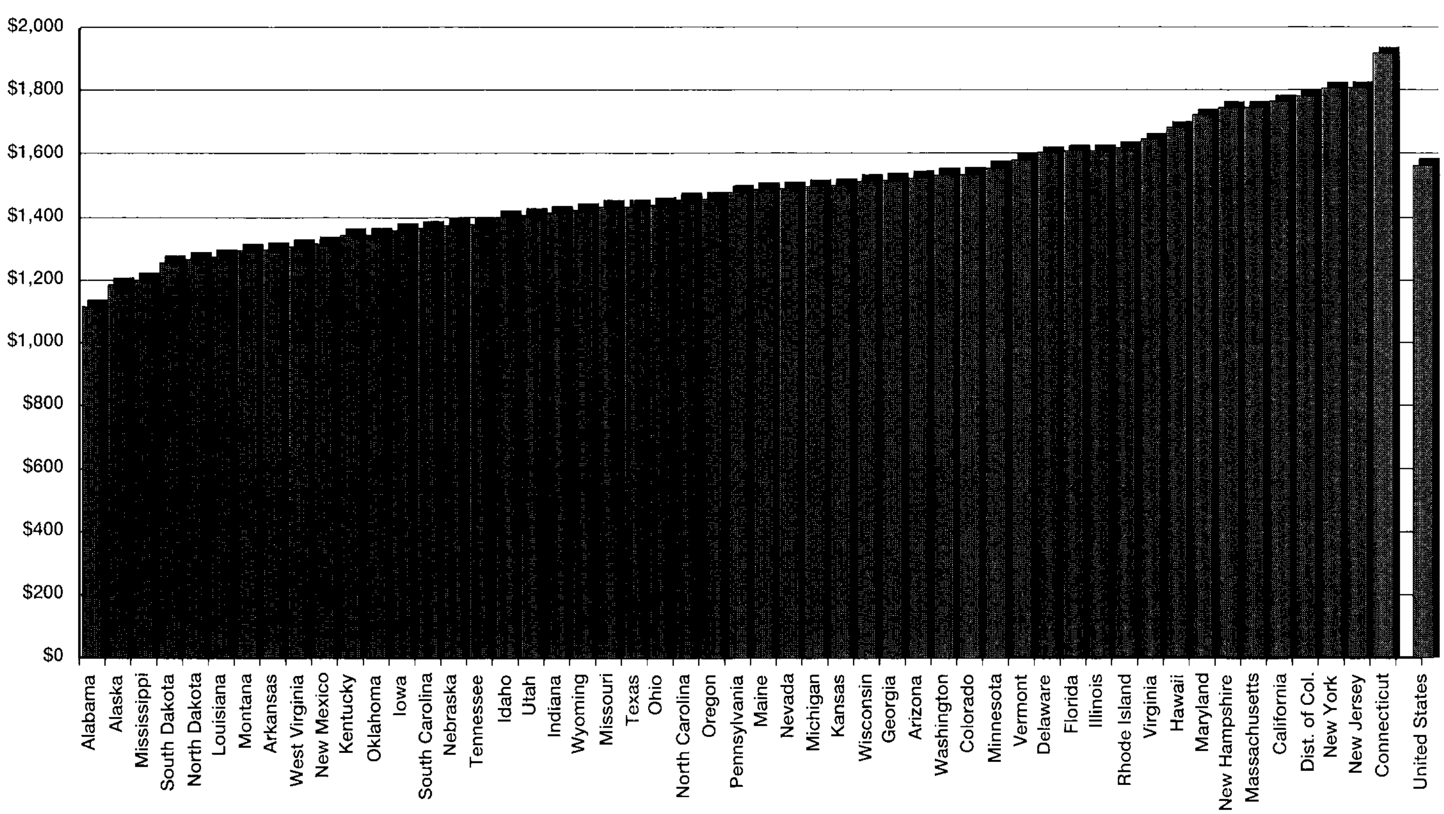
The spousal IRA provision extends the current laws governing contributions to individual retirement accounts by allowing a deductible contribution of $2,000 annually for each spouse. The one condition is that the combined compensation of both spouses must at least equal the contributed amount.

Senior Citizens' Equity Tax Act

Repeal of the 1993 Income Tax Increase on Social Security Benefits

A complicated formula dictates how much of a taxpayer's Social Security benefits must be included in his gross income if his income exceeds a certain threshold. In 1993, the amount of income in excess of the threshold that was subject to taxation increased from 50 percent to 85 percent. Beginning in 1996, the Contract would reduce the percentage of income subject to taxation by 10 percentage points annually until the percentage is returned to its 50 percent level in the year 2000.

Figure 2
Average Tax Reduction Per Tax Filer under "Contract With America" Tax Provisions, By State



Source: Tax Foundation.

Treatment of Long-Term Care Insurance and Services

In general, current law lacks specific rules for the tax treatment of long-term care insurance and services. The Contract provision would put long-term care insurance and services on a par with the specific tax rules relating to medical expenses and accident or health insurance. The result would be to increase taxpayers' allowable tax deductions.

Tax Treatment of Accelerated Benefits under Life Insurance Contracts

Many life insurance plans also double as investments. If an insured person begins to receive payments from a life insurance contract before death, the amount received in excess of the amount invested must be included in gross income. Further, if the insurance contract fails to meet the strict rules defining a "life insurance contract," then the undistributed investment income earned on the premium payments are also subject to tax. The Contract With America provision would exclude from gross income (1) any amount a taxpayer received under a life insurance contract and (2) any income from the sale or assignment of a life insurance contract to a qualified viatical settlement provider, provided that the insured person is diagnosed as terminally or chronically ill.

Increase in the Social Security Earnings Limit

This provision is its own title in the Contract With America, not specifically a part of the Senior Citizen's Equity Tax Act. The earnings limit is a rule almost as old as the Social Security system itself. As the rule is written in 1995, any Social Security recipient between the age of 65 and 69 loses $1 in Social Security benefits for every $3 he earns over $11,280. The earnings limit increases each year in proportion to the growth of wages in the U.S. economy. The Contract provision would accelerate the growth of the limit, by approximately $4,000 annual increments, up to $30,000 by the year 2000.

Job Creation and Wage Enhancement Tax Act

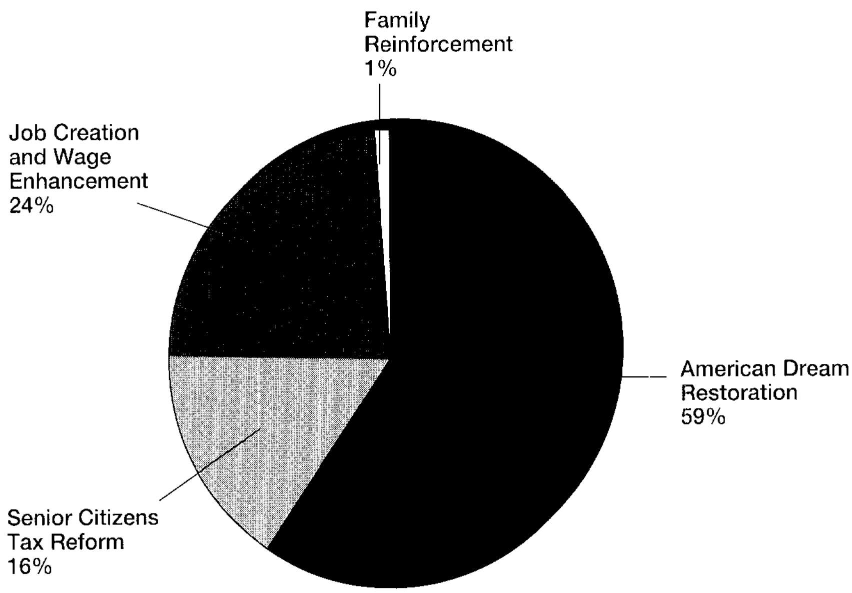
This Act contains several corporate income tax provisions. These provisions are not covered here because their net effect amounts to an estimated 5-year tax reduction of less than $1 billion. The provisions deal with corporate capital gains, the rules associated with depreciating capital assets, and the repeal of the corporate alternative minimum tax.

Table 4
Average Tax Reduction Per Tax Filer under "Contract With America" Tax Provisions, By State

State	Average Tax Reduction Per Filer	Rank
Alabama	$1,114	51
Alaska	1,184	50
Arizona	1,523	19
Arkansas	1,296	44
California	1,761	5
Colorado	1,534	17
Connecticut	1,913	1
Delaware	1,599	14
Dist. of Col.	1,776	4
Florida	1,605	13
Georgia	1,517	20
Hawaii	1,678	9
Idaho	1,376	36
Illinois	1,605	12
Indiana	1,413	33
Iowa	1,357	39
Kansas	1,499	22
Kentucky	1,341	41
Louisiana	1,273	46
Maine	1,487	25
Maryland	1,718	8
Massachusetts	1,741	6
Michigan	1,496	23
Minnesota	1,554	16
Mississippi	1,199	49
Missouri	1,431	31
Montana	1,293	45
Nebraska	1,372	37
Nevada	1,489	24
New Hampshire	1,741	6
New Jersey	1,803	2
New Mexico	1,315	42
New York	1,802	3
North Carolina	1,453	28
North Dakota	1,265	47
Ohio	1,439	29
Oklahoma	1,342	40
Oregon	1,456	27
Pennsylvania	1,477	26
Rhode Island	1,615	11
South Carolina	1,364	38
South Dakota	1,254	48
Tennessee	1,398	35
Texas	1,432	30
Utah	1,405	34
Vermont	1,576	15
Virginia	1,640	10
Washington	1,532	18
West Virginia	1,306	43
Wisconsin	1,512	21
Wyoming	1,421	32
United States	$1,559	

Source: Tax Foundation.

Figure 3
The Distribution of Tax Reduction Provisions in the "Contract With America," 1995-2000



Source: Tax Foundation.

Individual Capital Gains Tax Reform

In general, the Contract introduces three provisions that would reduce the tax burden on individuals' capital gains. First, it would eliminate the current 28 percent maximum rate on capital gains and instead allow taxpayers to exclude 50 percent of their long-term capital gains from taxation. Second, it would allow taxpayers to adjust ("index") their capital gains (but not losses) for the effects of inflation. The indexing would work by allowing taxpayers to increase the purchase price of a capital asset by the cumulative rate of inflation since the date of purchase. Third, losses that result from the sale or exchange of a principle residence would be treated as a deductible capital loss rather than, as traditionally, a nondeductible personal loss.

Small Business Incentives

The Contract provides for three primary sources of tax incentives for small business: (1) estate and gift tax reform, (2) an increase in the amount of capital investments that may be expensed, and, for those that run a business out of their home, (3) clarification of the definition of a principle place of business for business deduction purposes. (A less prominent provision would eliminate business preferences under the individual alternative minimum tax.)

One disincentive facing a growing small business is the federal gift and estate tax imposed when a family's business is passed on to future generations. By imposing a levy on lifetime transfers and transfers at death, the gift tax and the estate tax create a tax liability that often forces the outright sale of the business. Currently, a total of $600,000 in cumulative transfers is exempted from the gift and estate tax. The Contract would, over a three year period ending in 1998, incrementally increase the exemption to $750,000 and index the exemption for inflation thereafter.

Under current law, a small business taxpayer with a sufficiently small amount of annual investment in a given tax year may, in lieu of depreciation, simply expense up to $17,500 of the investment. Beginning in 1996, the Contract would incrementally increase the current deductible amount to $35,000 by the year 1999. The increments would be $5,000 per year, except for the $2,500 final increment.

The final small business provision would clarify (and, in effect, expand) the definition for tax purposes of home offices. This provision would generally increase allowable deductions for home-office expenses.

Family Reinforcement Tax Act

Tax Credit for Adoption Expenses

This provision would introduce into law a maximum nonrefundable tax credit of $5,000 per child for qualified adoption expenses incurred by a taxpayer. Examples of qualified expenses would include adoption fees, court costs, and legal fees. An eligible child would be under 18 years of age or mentally incompetent to care for himself or herself. Adoption of a spouse's child or surrogate parenting arrangements would not qualify for the credit.

Tax Credit for Home-Care of Certain Elderly Family Members

This provision would provide a nonrefundable $500 tax credit for each qualified elderly family member. A qualified family member would be subject to a relationship test and a residency test.

SPECIAL REPORT (ISSN 1068-0306) is published at least 10 times yearly by the Tax Foundation, an independent 501(c)(3) organization chartered in the District of Columbia.

4-12 pp.
Annual subscription: $25.00
Individual issues $5.

The Tax Foundation, a nonprofit, nonpartisan research and public education organization, has monitored tax and fiscal activities at all levels of government since 1937.

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