CBO report lays out options for shrinking the deficit

The nonpartisan Congressional Budget Office (CBO) released a two-volume report on December 7 describing a range of different tax and spending options that lawmakers may consider for reducing the federal debt over the next decade (from 2023-2032).

CBO releases such reports periodically and the options presented are culled from legislative proposals, previous presidential budget submissions to Congress, and proposals from the private sector. The agency does not attempt to rank deficit-reduction options or recommend specific policies over others, nor does it consider the report to be an exhaustive list of potential remedies.

'Daunting' fiscal outlook

CBO notes that this latest report comes as the US faces a "daunting fiscal outlook" characterized by unprecedented deficit and debt projections.

"In CBO's May 2022 baseline projections, which reflect the assumption that current laws governing taxes and spending generally remain unchanged, federal debt held by the public rises from 98 percent of gross domestic product (GDP) in 2022 to 110 percent of GDP in 2032 and 185 percent of GDP by 2052," the agency said in a release accompanying the report. "The cost of interest on the debt doubles as a share of GDP over the next 10 years and continues to increase thereafter."

"To put the federal budget on a sustainable long-term path, lawmakers would need to make significant policy changes—taking actions to cause revenues to rise more than they would under current law, reducing spending to amounts below those currently projected, or adopting some combination of those approaches," CBO continued. "The nation has time to implement such changes, and [this report] indicate[s] the potential magnitude of effects from a broad range of actions."

Highlights of 'larger' options

The first volume of the report provides detailed discussions and estimates for 17 tax- and spending-focused options, each of which would have what CBO characterizes as a "larger" deficit-reduction impact of $300 billion or more over the 10-year budget window.
URL: https://www.cbo.gov/system/files/2022-12/58164-budget-options-large-effects.pdf

Modifications to existing tax provisions: Several of the tax-related options would generate additional federal revenue by modifying provisions already in the Internal Revenue Code. Among the more notable examples are:

- Increasing all tax rates on individual income by 1 percentage point (estimated 10-year revenue increase: $1.1 trillion);

- Eliminating all itemized deductions (estimated 10-year revenue increase: $2.51 trillion) or limiting the tax benefits of itemized deductions to 15 percent of their total value (estimated 10-year revenue increase: $1.36 trillion);
- Expanding the application of Social Security payroll taxes to include earned income over the current-law cap of $250,000 (10-year deficit reduction of $1.2 trillion); and
- Limiting the income and payroll tax exclusion for employer-provided health insurance to the 50th percentile of premiums (estimated 10-year revenue increase: $893.2 billion).

Potential new taxes: The report also identifies options to increase revenue through the imposition of new taxes such as:

- A 2 percent payroll tax (to be paid entirely by employees) on all earned income that would apply *in addition to* existing payroll taxes for Social Security and Medicare (estimated 10-year revenue increase: $2.25 trillion);
- A 5 percent value-added tax that would apply to a broad base that encompasses most goods and services (estimated 10-year revenue increase: $3 trillion) or to a narrower base that excludes certain essential goods and services (estimated 10-year revenue increase: $1.95 trillion);
- A surtax of 1 percentage point on individual adjusted gross income above the standard deduction and exemption (estimated 10-year revenue increase: $1.33 trillion); and
- A tax on greenhouse gas emissions of $25 per metric ton, subject to an annual increase of 5 percent, indexed for inflation (estimated 10-year revenue increase: $865.4 billion).

Options for 'smaller' deficit reductions

The report's second volume identifies 59 options for spending cuts or tax increases that CBO contends would shrink federal deficits by "smaller" amounts—generally between $10 billion and $300 billion over the 10-year budget window.
URL: https://www.cbo.gov/system/files/2022-12/58163-budget-options-small-effects.pdf

Business-focused tax increases: Among the revenue-raising options that would affect business taxpayers are:

- Increasing the corporate income tax rate by 1 percentage point (estimated 10-year revenue increase: $129.3 billion);
- Requiring half of advertising expenses to be amortized over 10 years (estimated 10-year revenue increase: $154.2 billion);
- Repealing the "last in, first out" approach to inventory identification and the "lower of cost or market" and "subnormal goods" methods of inventory valuation (estimated 10-year revenue increase: $90.4 billion);
- Repealing the low-income housing tax credit (estimated 10-year revenue increase: $76.8 billion);
- Increasing all taxes on alcoholic beverages to $16 per proof gallon and indexing them for inflation (estimated 10-year revenue increase: $114.1 billion); and

- Increasing excise taxes on motor fuels by 15 cents per gallon and indexing them annually for inflation (estimated 10-year revenue increase: $240.1 billion).

Individual-focused tax increases: Potential "smaller" revenue-raising options on the individual side of the tax code include, among other things:

- Imposing a new tax—generally at a rate of 0.01 percent—on the purchase of most securities and on transactions involving derivatives (estimated 10-year revenue increase: $263.7 billion);
- Increasing the tax rates on long-term capital gains and qualified dividends by 2 percentage points (estimated 10-year revenue increase: $102.1 billion);
- Limiting deductibility of charitable contributions to contributions exceeding 2 percent of adjusted gross income (estimated 10-year revenue increase: $271.5 billion);
- Eliminating the step-up in basis for inherited assets (estimated 10-year revenue increase: $156.4 billion);
- Expanding the base of the net investment income tax to include the income of active participants in S corporations and limited partnerships (estimated 10-year revenue increase: $248.9 billion);
- Treating carried interests that general partners receive for performing investment management services as labor income, taxed at ordinary income tax rates and subject to the self-employment tax (estimated 10-year revenue increase: $11.5 billion); and
- Reducing maximum allowable contributions to tax-preferred retirement savings plans to $17,500 per year for 401(k)-type plans and $5,000 per year for IRAs (estimated 10-year revenue increase: $152.3 billion).

Template for future legislation?

Although the options presented in these reports generally are not turned directly into legislative proposals, they are sometimes introduced in modified form as lawmakers set policy goals or search for additional ways to increase federal revenues or cut spending.

CBO notes that because primary deficits (defined as deficits minus net interest outlays) are projected to total $7.7 trillion over the 10-year budget window, "even the largest" of the options presented in the report "would not be sufficient by itself to eliminate the projected deficits."

— Michael DeHoff
Tax Policy Group
Deloitte Tax LLP