Notes on Health Care Reform Financing & Related Issues

Citizens for Tax Justice May 1994

As the health care reform process unfolds, there has been much debate over what kind of subsidies should be provided to small, low-wage employers and to lower-income families to purchase health insurance—and just as important, how to pay for those subsidies. Among the major proposals for financing premium subsidies that have been discussed so far are:

- Make workers pay personal income taxes and Social Security taxes on employer-provided health insurance that costs more than a specified dollar amount. President Clinton's plan generally rejects this idea, but it has recently generated new attention. A variant on this approach, included in the Cooper-Breaux plan, would impose a 34% excise tax on employee health benefits above a designated dollar amount. Although technically a tax on employers, this excise tax would almost certainly be passed on to workers in lower wages or benefits.
- Large increases in cigarette taxes: 75 cents a pack under President Clinton's proposal and $1.25 a pack under a bill reported by the Ways and Means Health Subcommittee.
- A mandate that health insurers provide below-cost health coverage to lower-income families. This approach, which would seem to require higher health insurance premiums for fully paying customers, is a central feature of the Cooper-Breaux plan.

Like others who have analyzed them, we find very substantial structural problems in the various proposed employer subsidies. In addition, most of the leading suggested financing schemes are unwieldy and/or regressive, and we believe that fairer alternatives should be considered. These issues are closely linked, and they go to the heart of what kind of health care reform we really want.

I. Problems with Employer Subsidy Schemes.

The Clinton health reform plan would subsidize employer health costs by limiting premiums to the lesser of actual dollar costs or a certain percentage of payroll, based on firm size and average wages. These and similar "premium caps" produce many very odd results in the incremental health insurance costs they impose for hiring new workers or raising workers' average pay. For example, under the Clinton system:

- A firm with 49 employees making an average of $21,000 each will pay $1,491 per worker for health insurance, or 7.1% of wages. But if it hires a 50th worker, that employee's health insurance will cost the firm almost $10,000—nearly half the added worker's cash pay.

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■ If that same firm raises its workers' average pay by $1 (a total of $49/year), its annual health premiums will go up by more than $8,000—168 times the total pay raise.

■ A firm with 74 employees making an average of $12,000 each will pay more than $24,000 in added health insurance costs if it hires one additional worker.

■ A 74-worker firm paying an average wage of $18,000 will pay more than $10,600 in added health insurance costs if it raises its average wage to $18,001.

Employer Health Cost Increase from A $1 Average Pay Raise Under the Clinton Plan

# of wrkrs	Average pay before $1 increase				
	$12,000	$15,000	$18,000	$21,000	$24,000
24	$+2,593	$+3,241	$+3,889	$+4,538	$+4,610
25	+2,701	+3,377	+4,052	+4,202	+2
49	+5,295	+6,618	+7,941	+8,236	+4
50	+5,403	+6,754	+7,204	+4	+4
74	+7,997	+9,995	+10,662	+6	+6

These "cliff" effects are caused by the abrupt increases in the percentage caps on employer health premiums when the number of employees or average pay exceeds certain thresholds.[1] For example, health premiums for a firm with 24 employees paying an average wage of $12,000 are capped at 3.5% of payroll, or $10,080. But a firm with 25 employees paying an average wage of $12,001 has a health premium cap of 5.3%, or $15,901. Thus, the second firm will pay over 50% more per employee for health insurance than the first.

Employer Health Insurance Costs PER ADDED WORKER Under the Clinton Proposal

Worker #	Pay per Worker						
	$12,000	$12,001	$15,000	$15,001	$18,000	$18,001	$21,000
1st 24 ave.	$420	$528	$660	$795	$954	$1,116	$1,302
25th Wrkr	3,120	3,228	4,035	4,170	5,004	5,166	6,027
26-49 ave.	528	636	795	930	1,116	1,278	1,491
50th Wrkr	5,928	6,037	7,545	7,681	9,216	8,478	9,891
51-74 ave.	636	744	930	1,065	1,278	1,422	1,659
75th Wrkr	24,036	16,045	20,055	10,066	12,078	1,422	1,659

To be sure, a somewhat complicated marginal system could be devised that avoids the cliffs of the Clinton plan, while retaining a two-factor approach based both on firm size and average wages.[2] But even without cliffs, Clinton-style business health subsi-

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[1]The Clinton % of wage caps on health premiums are:

# of wrkrs	Average Pay per Worker					
	$0–$12,000	$12,001–15,000	$15,001–18,000	$18,001–21,000	$21,001–24,000	$24,001 or more
1–24	3.5%	4.4%	5.3%	6.2%	7.1%	7.9%
25–49	4.4%	5.3%	6.2%	7.1%	7.9%	7.9%
50–74	5.3%	6.2%	7.1%	7.9%	7.9%	7.9%
75–5,000	7.9%	7.9%	7.9%	7.9%	7.9%	7.9%
5,001+	*no cap for first five years, capped later at 7.9%*					

[2]A "cliffless" version of the Clinton approach, for instance, might look like this (see the appendix for illustrations):

1. Calculate the tentative cap using the table below (based on # of workers).
2. Subtract $12,000 from your average wage paid. If zero or less, then line 1 is your cap.
3. Subtract line 1 from 7.9%.
4. Divide line 3 by 12,000.
5. Multiply line 4 times line 2.
6. Sum lines 1 and 5. That or 7.9% if less is your cap.

#Wkrs	Tentative Cap
<=15	3.5% ....
16-24	3.5% plus 0.090% times # wrkrs > 15
25-49	4.4% plus 0.036% times # wrkrs > 25
50-74	5.3% plus 0.104% times # wrkrs > 50
75+	7.9% ....

dies lead to major definitional problems: Who is an employee? What counts as wages? What qualifies as a separate firm? The answers to these questions will have significant financial consequences. And no matter how they are resolved, there is no doubt that employers will try to rearrange their affairs to maximize their subsidies. Contracting out low-wage services, for example, would be one way to game the system.

In truth, a complicated, multiple-rate, Clinton-style system of subsidies for small companies with low-paid workers shouldn't be necessary. Even a *single* percentage-of-wages cap on health premiums, applicable to *all* employers, has significant built-in subsidies, because companies that pay low wages also will pay quite low amounts in health premiums. If a single cap were set at 7.9% of wages, it would cost the government less than the Clinton approach—or alternatively the cap could be somewhat lower than Clinton's 7.9% maximum. For example:

- With a single 7.9% cap, a firm that pays its workers $12,000 each will pay only $948 per worker in health insurance premiums—a discount of 50-74% from the market rate (depending on the workers' family status).
- A firm that pays its workers $18,000 each will pay $1,422 per worker for health insurance premiums under a 7.9% cap, still far below the likely market rate.

If we want to avoid creating incentives for businesses to restructure, however, we must rethink the whole concept of having employers pay the lesser of actual insurance costs or a percentage of wages. Instead, there should be a fixed percent-of-wages health premium *with no dollar limit*—similar to the current Medicare tax. The rate for such a premium could be considerably lower than 7.9% (say, 6%). As the simple example in the following table illustrates, this is the only way to limit health costs for employers of low-wage workers without creating unfair and economically unsound advantages for restructuring.

Incentives to Restructure Firms under Premium Cap Schemes: A Simple Example
(Assumes $3,600 employer premium/worker before caps/subsidies)

	One Firm	Split Firm in Two			% Change from Splitting
		Firm 1	Firm 2	Total	
Worker 1 wage	$12,000	$12,000			
Worker 2 wage	12,000	12,000			
Worker 3 wage	90,000		$90,000		
Worker 4 wage	90,000		90,000		
Total wages	$204,000	$24,000	$180,000	$204,000	
Average wage	$51,000	$12,000	$90,000	51,000	
Premiums—					
With Clinton subsidies	**$14,400 (7.1%)**	$840	$7,200	**$8,040 (3.9%)**	**–44%**
With maximum of 7.9%	**$14,400 (7.1%)**	1,896	7,200	**$9,096 (4.5%)**	**–37%**
Compare: 6% premium with no dollar cap	***$12,240 (6.0%)***	*1,440*	*10,800*	***$12,240 (6.0%)***	**—**

A straight, uncapped percentage of payroll assessment to cover the employer share of health insurance addresses other problems as well. Notably, unfair distinctions between one-earner and two-earner couples with similar total incomes would be avoided. Under the Clinton approach, for example, two-earner couples (and their employers) would pay 73% more for health insurance than one-earner couples (and employers) would pay. In contrast, under a percentage of payroll assessment, couples with similar incomes would pay similar amounts, regardless of whether there were one or two earners in the family.

Premiums for One- and Two-Earner Couples with Kids† Under the Clinton Health Plan

2-Earner Couple	**Plan Cost**	**# Wkrs Adj.***	**Emp'er Share**	**Amount Paid**	**% of Cost**
Employer 1	$5,565 x	68% x	80% =	$3,033	
Employer 2	5,565 x	68% x	80% =	+3,033	
			Employers pay	$6,066	109%
			Couple additionally pays**	+1,113	20%
			TOTAL PAID	**$7,178**	**129%**
***Compare:* 1-Earner Couple**	**Plan Cost**	**# Wkrs Adj.***	**Emp'er Share**	**Amount Paid**	**% of Cost**
Employer	$5,565 x	68% x	80%	$3,033	54%
			Couple additionally pays**	+1,113	20%
			TOTAL PAID	**$4,146**	**74%**

†Similar discrepancies occur between one- and two-earner couples without children.
*Under the Clinton plan, the "number of workers adjustment" equals the total number of families in an insured class divided by the total number of workers in such families.
**Couples would pay 20% of the full plan cost.
See CBO, *An Analysis of the Administration's Health Proposal* (Feb. 1994), p. 30.

Of course, it might be pointed out that setting employer health costs as a straight percentage of payroll without a dollar cap violates basic insurance principles. *But that's an objection that applies to virtually all the serious health reform plans now on the table*, as the following section discusses.

II. What Do We Want From Health Care Reform?

Most Americans say we want everyone to have health insurance. But we don't really mean precisely that. What we really mean is that everyone should get the health care they need, regardless of their ability to pay for it. It's a big difference, and nothing illustrates it better than the much-touted, apparently universally-accepted idea of "community rating" for health insurance.

Under standard insurance rules, people pay more for insurance if they're likely to file more claims. Thus, teenage boys, quite reasonably, are charged a lot more for auto insurance than middle-aged women. The same principal makes health insurance for a 50-year-old considerably more expensive than coverage for a 25-year-old.

For people who need health care the most, health insurance currently may be unaffordable or even unavailable at any price. After all, it doesn't make business sense for an insurance company to sell coverage to, say, a known AIDS victim whose costs will almost certainly far exceed any premiums that might be collected.

"Community rating" would turn the concept of health insurance on its head. Instead of charging high-risk people more and low-risk people less, everyone would pay about the same amount for insurance (perhaps adjusted for family type and region).

That means that sick or likely-to-be-sick people would pay less—perhaps much less—than they pay now, while healthy people would pay more.

Community rating appears to be one of the key things most of us want from health care reform, but it's clearly no longer "insurance" in the normal sense of the word.[3] So it's odd that most of the major reform proposals now before Congress—excluding "single-payer"—maintain the framework of the insurance model and keep insurance companies and quasi-premiums in the system. In fact, it's not only odd, it's one of the main sources of complexity in all of the non-single-payer plans, whether the President's, the sketchy Cooper-Breaux scheme or the various Republican alternatives.

If insurance companies must charge everyone the same for health insurance, their logical incentive would be to seek out the healthiest people to insure. So, of course, that practice must be outlawed. Thus, under all the plans, insurance must be sold to all comers regardless of their "preexisting conditions" or risk status. (The Cooper-Breaux plan would allow higher charges based on age, but not for other risk factors.)

Inevitably, however, some insurance companies, by luck, guile, location or whatever, will end up with healthier customers than others. Since that's not fair, all the reform plans require that every year, insurers with relatively low claims send money to insurers with relatively high claims. Even large businesses that choose to self-insure their employees must pay into (or can get money out of) the pool. The regulatory apparatus necessary to try to make this "non-insurance insurance system" work will be enormous and complex—and quite likely, unworkable.

Of course, if healthier people are going to have to pay considerably more for insurance, then many of them might prefer not to buy it, or to buy only the most stripped-down coverage. Even today, many young, healthy people choose not to buy health insurance (if they have the option not to) because they see it as a bad deal. Spending even $2,500 a year for insurance, when 9 times out of 10 your health care costs for a year will be under $500 doesn't look very attractive to many people. Of course, there's always a small risk that something catastrophic might happen. But many people might be willing to take that risk, in part because they figure they'll get care anyway, on a charity basis if necessary.

If lots of low-risk people opt out of the system, however, then community rating won't work. The Clinton plan addresses this problem by requiring everyone to have a specific, comprehensive amount of health insurance, usually paid for mostly by their employers, with subsidies for lower-income people, particularly those who work for smaller businesses. Many of the Republican plans have a similar mandate, but without the requirement that employers pay.

The Cooper-Breaux bill has some of the largest problems with community rating, because it doesn't force low-risk people (or anyone, for that matter) to buy insurance.

[3]Back when most health insurance was provided by nonprofit Blue Cross/Blue Shield insurers, a form of "community rating" was actually practiced. Families, for example, were heavily subsidized by non-family insurees. But once a large number of profit-seeking insurance companies entered the health insurance area, broke the Blues' government-sanctioned quasi-monopoly and introduced competition, that benevolent system became impossible to maintain.

To try to address this problem, Cooper-Breaux would prohibit healthy people from buying cheap, catastrophic-only coverage, by setting an apparently rather comprehensive minimum level of benefits that all insurance contracts must provide. (Exactly what the basic benefits package would include is left to the discretion of a board to be named later.) In addition, Cooper-Breaux's concept of community rating does not apply across age groups. By making age a factor in premium costs, the plan allows younger (usually healthier) people to pay lower rates than older people, thereby reducing the disincentive for the young to buy insurance.

Even with these features, however, the Cooper-Breaux plan would leave large numbers of families without insurance coverage—or more precisely, without insurance costs. As the bill is drafted, people would be allowed to buy "insurance" at the same time they show up at the hospital with a serious need for expensive treatment, making the bill's community rating scheme even more problematic. In other words, in their zeal to avoid "mandates," Sen. Breaux and Rep. Cooper apparently would allow people to freeload until they have a serious need for medical care.

Most of the advocates of "non-insurance insurance" argue that their approach has the advantage of building on current arrangements. But in fact, any proposal that entails community rating scraps the present health insurance system—whether its financing method is called a premium or a tax. The dubious distinction of non-insurance insurance plans is that their financing schemes and regulatory apparatuses are particularly unwieldy.

An honest and responsible debate over health care reform would focus on determining (1) what exactly are the kinds of health coverage that we do not want to leave to private decisions and market forces and (2) how much of that coverage we are willing to pay for through government (and how). Obviously, the two questions are—and must be—intertwined.

For example, we might conclude (perhaps for fiscal reasons) that only catastrophic coverage should be mandated and government-financed, and that the rest of health care (excluding coverage for the very poor) should be left to the marketplace. (Such an approach might be called "Single-Payer-Lite.") Or we might decide (maybe for health policy reasons) that broad coverage for preventative care also should be required, and that it's worth finding ways to pay for it. Or we might favor comprehensive government-financed health care coverage, as do other developed countries and as the leading "single-payer" plan would provide. But whatever we decide, the current quixotic preoccupation with trying to build a non-insurance-based system on top of an insurance model is an unhelpful diversion.

III. Problems with Regressive Financing Schemes.

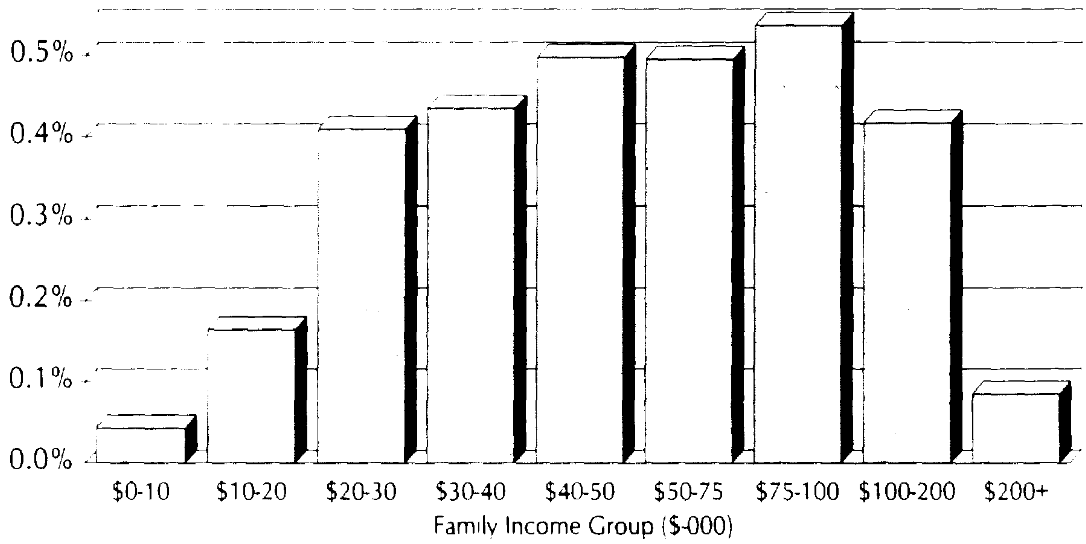
A. Taxing employee health benefits.

On Wednesday, April 20, 1994, the *Wall Street Journal* reported that proponents of taxing employer-paid health insurance benefits above a certain level are touting it as "progressive" tax reform. In fact, taxing health benefits looks anything but progressive if one compares its impact on middle-income families versus the wealthy.

A March Congressional Budget Office report analyzed the distributional impacts of applying personal income and Social Security payroll taxes to employer-paid health insurance above $4,000 for joint returns, $3,400 for heads of households and $1,600 for singles.[4] The report found that such a tax would cost middle-income families about half a percent of their incomes, but that the richest families would pay less than 1/10th of one percent of their incomes in added taxes.

CBO did find, as the chart illustrates, that most families at the bottom of the income scale (many of whom receive government-paid health coverage) would not be significantly affected by taxing employer-paid health benefits. But any tax change that hits middle-income families five or six times harder than the rich as a share of income can hardly be called "progressive."[5]

Taxing Employer-Provided Health Insurance Above a Cap As Shares of Family Income[4]



[4]Congressional Budget Office, *The Tax Treatment of Employment-Based Health Insurance* (March 1994).

[5]Distributionally, a tax on employer-paid health benefits (or a portion thereof) looks very much like a payroll tax on a capped amount of wages, such as the Social Security tax. CBO's analysis of "social insurance taxes"—mainly Social Security—finds that such taxes amount to 9-10% of family income for three quarters of family income groups, from the second income quintile up to the 95th percentile. The poorest fifth pay a lower rate, about 6%, because many in this group have no earned income. The richest pay much less—2.2% for the best-off 1 percent—because most social insurance taxes (except the Medicare tax) do not apply above a certain wage level. While the overall Social Security system constitutes a progressive pension program, no one would suggest that the Social Security payroll tax itself is progressive.

The Cooper-Breaux 34% excise tax

The 34% excise tax on "excessive" employer-paid health premiums proposed under the Cooper-Breaux plan was apparently intended to achieve a similar result to subjecting a portion of premiums to income and Social Security payroll taxes, but with the pretense that the burden of the added tax would fall on employers.[6] As drafted, however, the Cooper-Breaux excise tax would be very different from a direct employee tax on benefits.

To be sure, should the proposed excise tax induce employers to cut back on benefits by the "excessive" amounts and pay those amounts out in taxable wages, it would be essentially identical to making employees pay taxes on health benefits above a cap. But affected employers would much better serve their workers by maintaining the "excessive" health benefits, paying the excise tax and cutting wages to offset the net cost of the excise tax.[7] In that case, the employers would break even, while a large portion of the wage loss to workers would be offset by reduced income and FICA taxes.[8] (See tables in appendix.)

Thus, in practice the Cooper-Breaux excise tax would impose only about half the added burden of subjecting benefits above a cap to income and payroll taxes. Distributionally, however, it would be even more regressive (above the lowest income levels[9]) because of its flat rate.

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[6]The average marginal federal tax rate on wages (personal income and employer-employee social security taxes) for families of four is very close to 34%, although it varies considerably by income group, as the table and graph in the appendix illustrate. (State and local income taxes, which would probably apply if health benefits were included in personal taxable income above a cap, would add 3 to 5 percentage points to federal marginal rates.)

[7]As drafted, the Cooper-Breaux excise tax apparently would not apply to state and local governments and their employees. The tax applies to "the *excess health plan expenses* of any employer." Cooper-Breaux's new IRC §4980C(a). "'*Excess health plan expenses*' means health plan expenses paid or incurred by the employer . . . with respect to *any covered individual* to the extent such expenses" are above the limit. Cooper-Breaux's new IRC §4980C(b)(1). "The term '*covered individual*' means any beneficiary of a *group health plan*." Cooper-Breaux's new IRC §4980C(f)(1). "The term '*group health plan*' has the meaning given such term by *[current IRC] section 5000(b)(1)*." Cooper-Breaux's new IRC §4980C(f)(2). Current *IRC §5000(b)(1)* defines a '*group health plan*' as "*any plan of*, or contributed to by, *an employer* (including a self-insured plan) to provide health care (directly or otherwise) to the employer's employees, former employees, or the families of such employees or former employees." Current *IRC §5000(d)* says: "For purposes of this section, the term '*employer*' *does not include a Federal or other governmental entity*." So therefore, the Cooper tax, as drafted, does not apply to state & local governments. This most likely was an oversight, however.

[8]A major reason for the difference between the Cooper-Breaux excise tax and taxing employees on a portion of their health benefits is that employers could deduct the excise tax in computing their taxable income.

For that same reason, along with others, the excise tax also differs from denying employers a deduction for a portion of health benefits. (The tax increase from a deduction denial would not be deductible). In addition, denying an employer deduction would not affect non-profit companies. If the Cooper-Breaux excise tax were not deductible, it would be similar to a deduction denial for employees of top-bracket corporations, but much harsher than a deduction denial for employees of low-bracket companies, as well as for employees of non-profits.

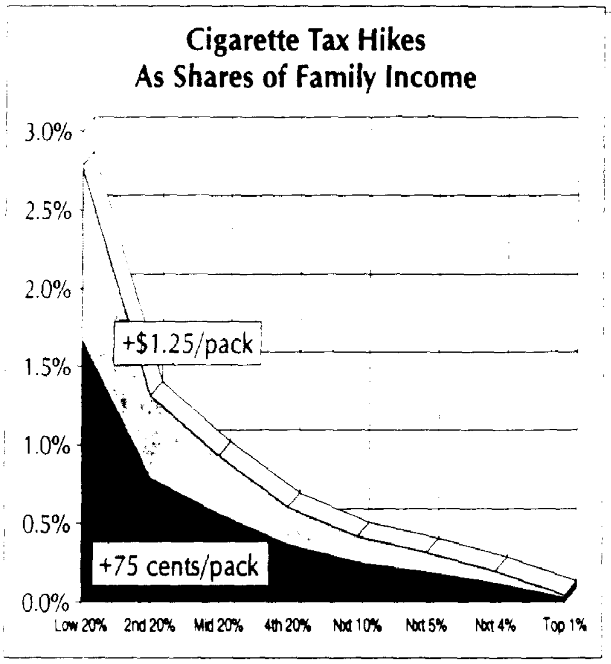
[9]Because of Cooper-Breaux's system of discounts for low-income people, the 34% excise tax would not appear to apply to health benefits—however lavish—provided to families until their incomes neared twice the official poverty line.

B. Cigarette tax increases.

Many of the leading health reform plans propose substantial increases in cigarette taxes. The President's plan to add 75¢/pack is estimated to boost gross tobacco taxes by $16 billion in fiscal 1995.[10] That's almost 40% as much in revenue as the $42 billion that all the much-debated tax hikes in the 1993 budget act will raise in fiscal 1995. The House Ways and Means Health Subcommittee has proposed a $1.25/pack cigarette tax increase, which would be about two-thirds as big as the 1993 tax hike.

Although the proposed cigarette tax hikes may be on the same order of magnitude as the 1993 tax changes, the two approaches to raising revenue differ markedly in their distributional effects. Unlike the progressive tax hikes of 1993, cigarette taxes are extremely regressive.

- According to CBO data, a 75¢/pack increase in the cigarette tax would take 1.7% of the income of the poorest 20% of American families, 0.6% from the middle 20%, but virtually zero percent of the income of the very rich.
- A $1.25/pack tax hike would take 2.8% of the income of the poor, almost 1 percent of the income of families in the middle, but again essentially nothing from the rich.
- In other words, as shares of income, cigarette taxes are 62 times as tough on the poor as on the rich, and 21 times as tough on the middle-class as on the rich.



One of the highly-touted features of the 1993 bill was the big boost in the earned-income tax credit for working families making less than $27,000. On average, the '93 act gave families in the bottom 40% of the income scale a tax *cut* of about $100 each.

- But the President's proposed 75¢/pack cigarette tax increase would cost families in the bottom 40% an average of $152 each per year. That would more than wipe out the tax relief those lower-income families got under the 1993 act.
- The proposed $1.25/pack increase would cost families in the bottom 40% an average of $254 each, *two-and-a half times* the tax relief they gained from the 1993 budget act.

[10] *Budget of the United States Government, Fiscal Year 1995, Historical Tables*, p. 33. After a 25% offset for reduced income and payroll tax revenues, the administration estimates that its proposed cigarette tax increase will raise $12 billion in fiscal 1995; *Budget of the United States Government, Fiscal Year 1995*, p. 189. The Congressional Budget Office and the Joint Committee on Taxation have published similar estimates.

It's strange that many who have bragged about the low-income tax relief in the 1993 budget act seem unconcerned about undoing it with sharply higher cigarette taxes. Proponents of higher cigarette taxes clearly hope to deter smoking, and whether tax hikes are an effective way to do so can be honestly debated.[11] But there can be no doubt that as a means of raising revenue, cigarette taxes are extraordinarily unfair.

Proposed Cigarette Tax Hikes Compared to Tax Changes under the 1993 Budget Act

Family Income Group	Average Income	Average Annual Tax Hike		*Compare: 1993 Tax Change*
		+75¢/pack	+$1.25/pack	
Lowest 20%	$8,470	$+141	$+235	*$–166*
Second 20%	$20,740	+163	+272	*–35*
Middle 20%	$33,650	+187	+312	*+64*
Fourth 20%	$48,970	+177	+296	*+110*
Next 10%	$68,210	+170	+283	*+239*
Next 5%	$88,340	+165	+276	*+388*
Top 5%	$221,500	+158	+263	*+7,305*
Average	$44,240	$+167	$+278	*$+382*
Note: Bottom 40%		*$+152*	*$+254*	*$–100*

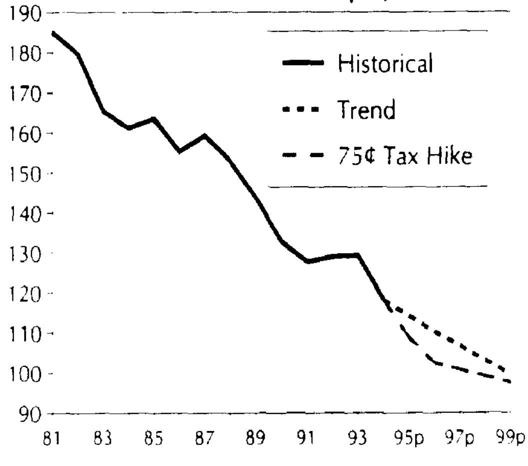
C. Insurer mandates.

In order to meet its budget targets, the Cooper-Breaux proposal includes an innovative feature that would require health insurers to provide below-cost coverage to lower-income families far beyond the subsidies provided by government. In effect, the Cooper-Breaux plan would institutionalize (and exacerbate) the kinds of cost-shifting that have been so heavily criticized under the current health insurance system. Presumably, the cost of such insurer-paid subsidies would have to be made up through higher premiums on paying customers. Thus, for families above the income cutoffs for subsidization under the Cooper-Breaux plan, this new insurer mandate essentially amounts to a flat dollar charge per family. Such a quasi-tax is not only implausible —the Congressional Budget Office says it would "cause turmoil" and huge "instability" in the health insurance market—but is also inherently very regressive.

[11]Some studies argue that higher tobacco taxes could significantly reduce smoking. But the administration's estimate of gross tobacco tax revenues under its proposed cigarette tax hike implies only a 2% projected total decline in taxable cigarette sales per person over age 15 from 1994 to 1999 compared to continuation of the trend over the past 15 years. The estimates of the Congressional Budget Office and the Joint Committee on Taxation are essentially identical.

These official estimates may be informed by the recent Canadian experience. After Canada increased its cigarette taxes by several dollars a pack a few years ago, legal purchases of cigarettes did plummet, but production of Canadian cigarettes (sold, essentially, only in Canada) did not fall. Instead, black-market sales proliferated. As a result, Canada has moved to roll back most of the tax increases.

Taxable Cigarette Sales (Packs) per Person > 15
Fiscal 1981 to Fiscal 1999 projected



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IV. Better Financing Alternatives.

Refocusing the health care debate back on fundamentals—on what kinds of health coverage we want to require everyone to have and how much of that coverage we are willing to pay for through government—can allow us to move beyond the evasions, impractical schemes and word games that have characterized much of the current political discussion. Instead, we can directly address the need to find fair, workable ways to pay for health care reform.

Reforming our health care insurance system does not require raising costs on low- and moderate-income working families. In fact, one of the central goals of reform should be to make health care a better deal for most people compared to what they pay now.

Rather than the complicated premium schemes with dollar and/or percentage caps that most of the current proposals would mandate or otherwise entail, we should look to broad-based, uncapped levies (i.e., taxes) based on people's ability to pay them. That means levies based on income or in the case of employers, on total payroll.

Last year's tax changes were a major step in the right direction—toward improved tax fairness. But the 1993 budget act didn't perfect the tax code, and its enactment hardly means that this year Congress should do just the opposite of what it did last year. Instead, further progressive tax reforms should be on the health-care-financing agenda.

How about, for example, cracking down on multinational corporate tax avoidance and evasion, as President Clinton promised in his campaign?

Why not, for another example, reinstate the Reagan-repealed tax on interest earned by foreigners on their U.S. investments?

Why not clamp down on corporate buying and selling of tax breaks, through elaborate "leasing" deals that are premised on outright "negative" tax rates—deals that are more profitable after-tax than before tax?

There ~~is~~ a long list of fair and needed tax reforms that could help pay for health care reform—without loading up new burdens on those least able to pay (see appendix). If Congress and the President are concerned about tax fairness and equitable health financing, these are the kinds of steps that ought to be taken to pay for health care reform.

Employer Health Insurance Costs PER ADDED WORKER
Under the Clinton Proposal

Worker #	Pay per Worker								
	$12,000	$12,001	$15,000	$15,001	$18,000	$18,001	$21,000	$21,001	$24,000
1st 24 ave.	$420	$528	$660	$795	$954	$1,116	$1,302	$1,491	$1,704
25th Worker	3,120	3,228	4,035	4,170	5,004	5,166	6,027	5,691	6,504
26-49 ave.	528	636	795	930	1,116	1,278	1,491	1,659	1,896
50th Worker	5,928	6,037	7,545	7,681	9,216	8,478	9,891	1,659	1,896
51-74 ave.	636	744	930	1,065	1,278	1,422	1,659	1,659	1,896
75th Worker	24,036	16,045	20,055	10,066	12,078	1,422	1,659	1,659	1,896
Employer Health Costs as a Percent of Workers' Pay:									
1st 24 ave.	3.5%	4.4%	4.4%	5.3%	5.3%	6.2%	6.2%	7.1%	7.1%
25th Worker	26.0%	26.9%	26.9%	27.8%	27.8%	28.7%	28.7%	27.1%	27.1%
26-49 ave.	4.4%	5.3%	5.3%	6.2%	6.2%	7.1%	7.1%	7.9%	7.9%
50th Worker	49.4%	50.3%	50.3%	51.2%	51.2%	47.1%	47.1%	7.9%	7.9%
51-74 ave.	5.3%	6.2%	6.2%	7.1%	7.1%	7.9%	7.9%	7.9%	7.9%
75th Worker	200.3%	133.7%	133.7%	67.1%	67.1%	7.9%	7.9%	7.9%	7.9%

Employer Health Cost Increase FROM A $1 AVERAGE PAY RAISE
Under the Clinton Plan

# of workers	Average pay before $1 increase						
	$12,000	$15,000	$18,000	$21,000	$24,000	$24,001	$50,000
24	$+2,593	$+3,241	$+3,889	$+4,538	$+4,610	$+2	—
25	+2,701	+3,377	+4,052	+4,202	+2	+2	—
49	+5,295	+6,618	+7,941	+8,236	+4	+4	—
50	+5,403	+6,754	+7,204	+4	+4	+4	—
74	+7,997	+9,995	+10,662	+6	+6	+6	—
75	+6	+6	+6	+6	+6	+6	—

Employer Health Cost Increase as a Percent of $1 Average Pay Raise

# of workers	Average pay before $1 increase						
	$12,000	$15,000	$18,000	$21,000	$24,000	$24,001	$50,000
24	10804%	13505%	16206%	18907%	19208%	7.9%	—
25	10805%	13506%	16207%	16808%	7.9%	7.9%	—
49	10805%	13506%	16207%	16808%	7.9%	7.9%	—
50	10806%	13507%	14408%	7.9%	7.9%	7.9%	—
74	10806%	13507%	14408%	7.9%	7.9%	7.9%	—
75	7.9%	7.9%	7.9%	7.9%	7.9%	7.9%	—

Clinton's Employer Health Cost Subsidies & a Proposed Alternative without Cliffs

# of Wkers	Average Wage	Clinton Cap	Proposed Cap	Proposed /Clinton	Clinton Cliffs		
					Ave. Cost Before	$1 Pay Raise	Add One Worker
15	12,000	3.5%	3.5%	100%			
15	12,001	4.4%	3.5%	80%	*$420*	$+1,621	
20	12,000	3.5%	4.0%	113%			
20	12,001	4.4%	4.0%	90%	*420*	+2,161	
24	12,000	3.5%	4.3%	123%			
24	12,001	4.4%	4.3%	98%	*420*	+2,593	
25	12,000	4.4%	4.4%	100%	*420*		$+3,120
25	12,001	5.3%	4.4%	83%	*420*	+2,701	+3,228
35	12,000	4.4%	4.8%	108%			
35	12,001	5.3%	4.8%	90%	*528*	+3,782	
49	12,000	4.4%	5.3%	120%			
49	12,001	5.3%	5.3%	99%	*528*	+5,295	
50	12,000	5.3%	5.3%	100%	*528*		+5,928
50	12,001	6.2%	5.3%	85%	*528*	+5,403	+6,037
62	12,000	5.3%	6.5%	124%			
62	12,001	6.2%	6.5%	106%	*636*	+6,700	
74	12,000	5.3%	7.8%	147%			
74	12,001	6.2%	7.8%	126%	*636*	+7,997	
75	12,000	7.9%	7.9%	100%	*636*		+24,036
75	12,001	7.9%	7.9%	100%	*744*		+16,045
15	$15,000	4.4%	4.6%	105%			
15	15,001	5.3%	4.6%	87%	*$660*	$+2,026	
20	15,000	4.4%	4.9%	112%			
20	15,001	5.3%	4.9%	93%	*660*	+2,701	
24	15,000	4.4%	5.2%	118%			
24	15,001	5.3%	5.2%	98%	*660*	+3,241	
25	15,000	5.3%	5.3%	100%	*660*		$+4,035
25	15,001	6.2%	5.3%	85%	*660*	+3,377	+4,170
35	15,000	5.3%	5.5%	105%			
35	15,001	6.2%	5.5%	89%	*795*	+4,727	
49	15,000	5.3%	5.9%	112%			
49	15,001	6.2%	5.9%	96%	*795*	+6,618	
50	15,000	6.2%	6.0%	96%	*795*		+7,545
50	15,001	7.1%	6.0%	84%	*675*	+6,754	+7,681
62	15,000	6.2%	6.9%	111%			
62	15,001	7.1%	6.9%	97%	*930*	+8,374	
74	15,000	6.2%	7.8%	126%			
74	15,001	7.1%	7.8%	110%	*930*	+9,995	
75	15,000	7.9%	7.9%	100%	*930*		+20,055
75	15,001	7.9%	7.9%	100%	*930*		+10,066

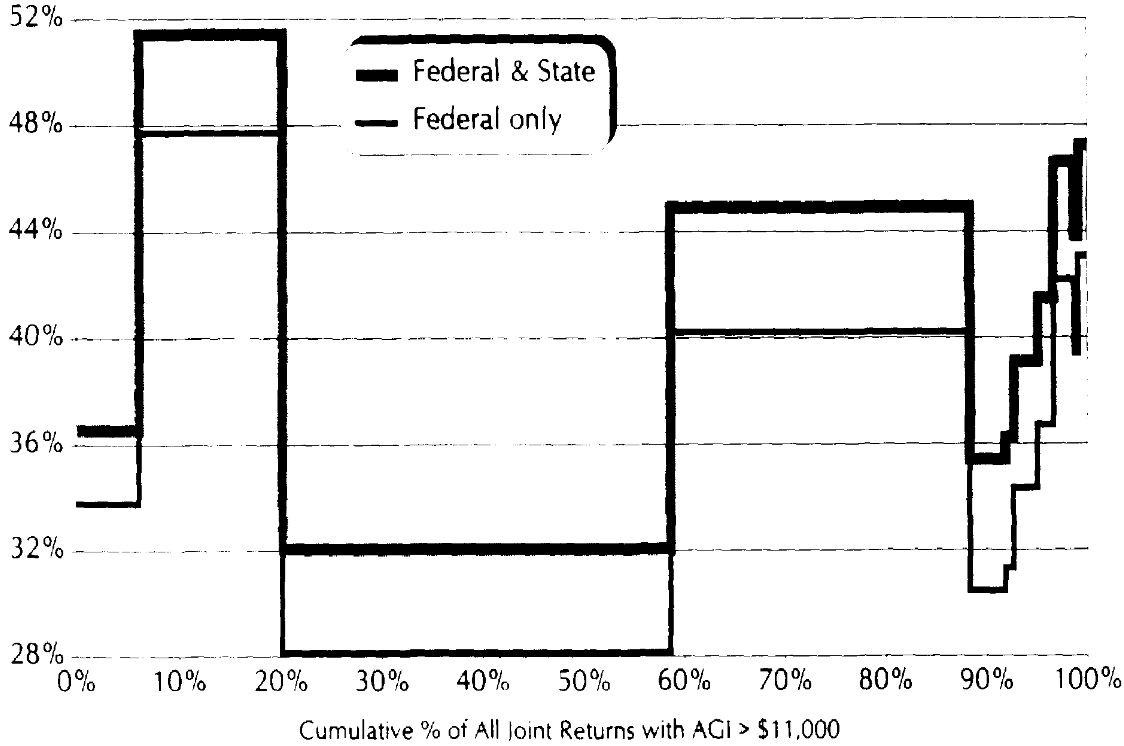
# of Wkers	Average Wage	Clinton Cap	Proposed Cap	Proposed /Clinton	Clinton Cliffs		
					Ave. Bef.	+$1 Pay	+1 Wker
15	**$18,000**	5.3%	5.7%	108%			
15	**18,001**	6.2%	5.7%	92%	*$954*	$+2,431	
20	**18,000**	5.3%	5.9%	112%			
20	**18,001**	6.2%	5.9%	96%	*954*	+3,241	
24	**18,000**	5.3%	6.1%	115%			
24	**18,001**	6.2%	6.1%	98%	*954*	+3,889	
25	**18,000**	6.2%	6.2%	99%	*954*		$+5,004
25	**18,001**	7.1%	6.2%	87%	*954*	+4,052	+5,166
35	**18,000**	6.2%	6.3%	102%			
35	**18,001**	7.1%	6.3%	89%	*1,116*	+5,672	
49	**18,000**	6.2%	6.6%	106%			
49	**18,001**	7.1%	6.6%	93%	*1,116*	+7,941	
50	**18,000**	7.1%	6.6%	93%			+9,216
50	**18,001**	7.9%	6.6%	84%	*1,116*	+7,204	+8,478
62	**18,000**	7.1%	7.2%	102%			
62	**18,001**	7.9%	7.2%	91%	*1,278*	+8,933	
74	**18,000**	7.1%	7.8%	111%			
74	**18,001**	7.9%	7.8%	99%	*1,278*	+10,662	
75	**18,000**	7.9%	7.9%	100%	*1,278*		+12,078
15	**$21,000**	6.2%	6.8%	110%			
15	**21,001**	7.1%	6.8%	96%	*$1,302*	$+2,836	
20	**21,000**	6.2%	6.9%	111%			
20	**21,001**	7.1%	6.9%	97%	*1,302*	+3,781	
24	**21,000**	6.2%	7.0%	113%			
24	**21,001**	7.1%	7.0%	99%	*1,302*	+4,538	
25	**21,000**	7.1%	7.0%	99%	*1,302*		$+6,027
25	**21,001**	7.9%	7.0%	89%	*1,302*	+4,202	+5,691
35	**21,000**	7.1%	7.1%	100%			
35	**21,001**	7.9%	7.1%	90%	*1,491*	+5,883	
49	**21,000**	7.1%	7.2%	102%			
49	**21,001**	7.9%	7.2%	92%	*1,491*	+8,236	
50	**21,000**	7.9%	7.3%	92%	*1,491*		+9,891
50	**21,001**	7.9%	7.3%	92%			
62	**21,000**	7.9%	7.6%	96%			
62	**21,001**	7.9%	7.6%	96%			
74	**21,000**	7.9%	7.9%	100%			
74	**21,001**	7.9%	7.9%	100%			
75	**21,000**	7.9%	7.9%	100%			
15	**$24,000**	7.1%	7.9%	111%			
15	**24,001**	7.9%	7.9%	100%	*$1,704*	$+2,881	
20	**24,000**	7.1%	7.9%	111%			
20	**24,001**	7.9%	7.9%	100%	*1,704*	+3,842	
24	**24,000**	7.1%	7.9%	111%			
24	**24,001**	7.9%	7.9%	100%	*1,704*	+4,610	
25	**24,000**	7.9%	7.9%	100%	*1,704*		$+6,504
					Note: Maximum Cliff Effects under Clinton	**$+10,662**	**$+24,036**

Marginal Tax Rates on Wages for Families of Four
(at 1994 Levels*)

1994 AGI	*Notes*	Federal Inc. Tax	FICA	Total Fed.Rate**	State Inc. Tax†	Federal & State
$1-8,425	*Earned-inc. tax cred. starts*	-40.0%	15.3%	**-22.9%**	1.0%	**-22.0%**
$8,425-11,000	*Maximum EITC base*	0.0%	15.3%	**14.2%**	2.0%	**16.1%**
$11,000-16,200	*EITC phase-out starts*	21.1%	15.3%	**33.8%**	3.0%	**36.6%**
$16,200-27,000	*15% bracket starts*	36.1%	15.3%	**47.7%**	4.0%	**51.4%**
$27,000-56,200	*EITC phase-out ends*	15.0%	15.3%	**28.1%**	4.2%	**32.0%**
$56,200-100,000	*28% bracket starts*	28.0%	15.3%	**40.2%**	5.0%	**44.9%**
$100,000-111,800	*OASDI tax ends‡*	28.0%	2.9%	**30.5%**	5.0%	**35.4%**
$111,800-126,000	*Itemiz. ded. disall. starts*	28.8%	2.9%	**31.3%**	5.0%	**36.3%**
$126,000-167,800	*31% bracket starts††*	31.9%	2.9%	**34.3%**	4.8%	**39.1%**
$167,800-196,000	*Pers. exe. phase-out starts*	34.4%	2.9%	**36.7%**	4.8%	**41.5%**
$196,000-290,300	*36% bracket starts††*	39.9%	2.9%	**42.2%**	4.5%	**46.6%**
$290,300-368,000	*Pers. exe. phase-out ends*	37.1%	2.9%	**39.4%**	4.5%	**43.8%**
$368,000+	*10% surtax starts††*	40.8%	2.9%	**43.1%**	4.2%	**47.2%**

**Including federal personal income taxes, FICA taxes (employer and employee) and approximate state and local income taxes. Federal figures assume 1993 EITC changes are fully phased in.*
***Taking account that employer portion of FICA is not subject to personal income tax or FICA tax.*
†Rough estimate. Net of federal itemized deduction offset, if applicable.
‡Treats approximately 85% of total AGI as wages, assumes a 70%-30% wage split between spouses and assigns marginal dollar of wages to higher-income spouse. ††Treats a portion of AGI (5%, 10% & 20%, respectively) as capital gains.
Citizens for Tax Justice, April 29, 1994

Marginal Tax Rates on Wages for Families of Four
(Above $11,000 in Adjusted Gross Income)



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Possible Employer Responses to the Cooper-Breaux 34% Excise Tax

(Assume $1,000 per employee in "excessive" health benefits; workers are joint filers with 2 kids)

1. Cut health premiums by $1,000 & raise wages by that amount (less employer FICA).
(Note: This is just like benefits becoming subject to income and FICA taxes.)

Wkr AGI Fam. of 4	Wkr Cash Pay Up	Worker FICA Tax	Wkr Fed Inc.Tax	Wkr St. Inc.Tax	Wkr Net Cash Pay	Lost Health Ins.	Net Loss to Wkr
$12,000	$+929	$+71	$+196	$+28	$+634	$-1,000	$-366
$17,000	+929	+71	+335	+37	+486	-1,000	-514
$35,000	+929	+71	+139	+39	+680	-1,000	-320
$60,000	+929	+71	+260	+47	+551	-1,000	-449
$105,000	+986	+14	+276	+50	+646	-1,000	-354
$115,000	+986	+14	+284	+50	+637	-1,000	-363
$130,000	+986	+14	+315	+48	+609	-1,000	-391
$175,000	+986	+14	+339	+48	+585	-1,000	-415
$200,000	+986	+14	+393	+44	+534	-1,000	-466
$300,000	+986	+14	+366	+44	+562	-1,000	-438
$375,000	+986	+14	+402	+42	+528	-1,000	-472

2. Keep "excessive" premiums, cut wages by $350 excise tax (net of employer FICA savings):

Wrk AGI Fam. of 4	Wage Cut	Worker FICA Ch.	Wkr Fed IncTax Ch.	Wkr State IncTax Ch.	Worker Net Loss	*LossHere /Above*
$12,000	$ **	$ **	$ **	$ **	$ **	–
$17,000	**	**	**	**	**	–
$35,000	-316	-24	-47	-13	-231	*72%*
$60,000	-316	-24	-88	-16	-187	*42%*
$105,000	-335	-5	-94	-17	-220	*62%*
$115,000	-335	-5	-97	-17	-217	*60%*
$130,000	-335	-5	-107	-16	-207	*53%*
$175,000	-335	-5	-115	-16	-199	*48%*
$200,000	-335	-5	-134	-15	-182	*39%*
$300,000	-335	-5	-124	-15	-191	*44%*
$375,000	-335	-5	-137	-14	-179	*38%*

**Reflects negative federal income tax rates because of the earned-income tax credit.*
***Workers at these income levels apparently cannot receive "excessive" benefits under the Cooper-Breaux plan because the cost of their premiums is heavily subsidized.*

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Effects of Denying an Employer Deduction for "Excessive" Health Benefits
(Assume $1,000 per employee in "excessive" health benefits; workers are joint filers with 2 kids)

Top-bracket corporation; keep "excessive" premiums, cut wages by amount needed to break even:

Wrk AGI Fam. of 4	Wage Cut	Worker FICA Ch.	Wkr Fed IncTax Ch.	Wkr State IncTax Ch.	Worker Net Loss	*Loss Here vs. Taxing Workers on Benefits*
$12,000	$-591	$-45	$-125	$-18	$-404	*110%*
$17,000	-591	-45	-213	-24	-309	*60%*
$35,000	-591	-45	-89	-25	-433	*135%*
$60,000	-591	-45	-166	-30	-351	*78%*
$105,000	-591	-9	-166	-30	-387	*109%*
$115,000	-591	-9	-171	-30	-382	*105%*
$130,000	-591	-9	-189	-29	-365	*93%*
$175,000	-591	-9	-203	-29	-351	*85%*
$200,000	-591	-9	-236	-26	-320	*69%*
$300,000	-591	-9	-219	-26	-337	*77%*
$375,000	-591	-9	-241	-25	-317	*67%*

Note: Worker losses from a deduction denial would be much less at lower-bracket companies.

Examples of Potential Tax Reforms

The 1993 budget act took back about 43 percent of the the tax cuts previously granted the wealthiest Americans by the supply-side tax cuts of the late seventies and early eighties. It did so primarily by increasing the top marginal personal income tax rate to 39.6 percent on the highest earners. But there is still more to do to restore tax progressivity. Future efforts to improve tax fairness should mainly be directed at closing loopholes that allow some corporations and high-income people to avoid paying their fair share. Items that could be addressed include:

1. **Tax capital gains the same as other income.** One of the greatest achievements of the 1986 Tax Reform Act was to tax capital gains at the same rates as wages, dividends or other income. (Previously, capital gains had been 60 percent tax-exempt). But in 1990, Congress reinstated a small capital gains preference, capping the rate at 28 percent while putting the top regular income tax rate at 31 percent. In the 1993 budget bill, this capital gains preference was expanded to provide a 30 percent exclusion for capital gains for top-bracket taxpayers (the difference between the new 39.6 percent top regular tax rate and a 28 percent maximum capital gains rate). In addition, the 1993 act provided an additional 50 percent capital gains exclusion for profits from certain "risky" investments that are considered likely to fail. Special breaks for capital gains, which threaten to revitalize the tax shelter industry, should be repealed. *The Joint Tax Committee estimates that "tax expenditures" for capital gains will total many tens of billions over the next five years (although the amount of revenue gain from closing capital gains loopholes that would be officially estimated is unclear at this time).*

2. **Tax capital gains on inherited property:** Currently, heirs can sell inherited property and pay no tax on gains that accrued prior to the time they inherit. Treasury analysts estimate that as much as two-thirds of all capital gains escape taxation entirely due to this loophole—which will cost in excess of $100 billion over the next five years. These built-up capital gains should be subject to tax at the time of inheritance. (Exceptions could be made for farms and closely-held businesses by delaying the tax until inherited property is sold.) *5-Year Revenue Gain: $20 billion-plus.**

3. **Reform estate & gift taxes:** Estate and gift taxes (which only apply to the very largest estates) can often be avoided through trusts, partial-interest gifts and other complex arrangements. These kinds of tax-avoidance schemes should be curbed. *5-Year Revenue Gain: $8 billion.*

4. **Curb excessive depreciation write-offs:** Businesses write off the cost of their equipment considerably faster than it actually wears out. This loophole—expanded in the 1986 Tax Reform Act—has proven much more expensive than originally anticipated; it's now estimated to cost more than $100 billion over the next five years. In fact, when equipment is purchased with borrowed money, the current system produces outright "negative" tax rates—such investments are more profitable after tax than before tax! As a result, corporate buying and selling of excess tax breaks through equipment "leasing" deals are widespread. Equipment "depreciation" write-offs should be scaled back to better reflect real wear and tear and obsolescence. *5-Year Revenue Gain: at least $25 billion.**

5. **End tax breaks for mergers & acquisitions:** The deductibility of corporate interest payments, even in the case of "junk bonds" and other types of debt that are more like stocks than real borrowing, helped fuel a wave of leveraged buyouts and other debt-for-stock transactions in the 1980s. From 1985 to 1990, more than $1 trillion in new corporate indebtedness was incurred, accompanied by $54 billion in corporate stock retirements—now costing the federal Treasury some $20-30 billion a year in lost corporate taxes. The deals that were struck then cannot be undone, but strict curbs on interest deductions on debt used to finance acquisitions, as well as other limitations on companies'

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*These revenue estimates are low in the early years, because it will take a number of years for the reforms to be fully phased in. The same is true for several of the other revenue figures shown here.

ability to mischaracterize equity as debt, are needed to keep this problem from resurfacing and making the revenue hemorrhage even worse. In particular, interest on debt incurred to purchase stock (in excess of, say, $5 million) should no longer be deductible, thereby stopping this perverse tax incentive for corporate debt.

In addition, many companies that made acquisitions in the eighties have taken extremely aggressive positions on their tax returns, in attempts to write off what they paid for "goodwill" and similar "intangible" assets. Billions of dollars in back taxes are at stake in litigation. The 1993 budget act actually allows these deductions for the future, which may encourage future acquisitions. That change should be repealed, and the law should be clarified to make crystal clear that *no* goodwill write-offs are allowed. *5-Year Revenue Gain: $9 billion.*

6. Tax multinational corporations: Multinational corporations, whether American- or foreign-owned, are supposed to pay taxes on the profits they earn in the United States. But our tax laws often fail miserably to achieve this goal. IRS data show that foreign-owned corporations doing business here typically pay far less in U.S. income taxes than do purely American firms with comparable sales and assets. The same loopholes that foreign companies abuse also are used by U.S.-owned multinationals, and even provide incentives for American companies to move plants and jobs overseas.

The problems in our taxation of multinational companies stem mainly from the complicated, almost unworkable approach we use to try to determine how much of a corporation's worldwide earnings relate to its U.S. activities. In essence, the IRS must try to scrutinize every movement of goods and services between a multinational company's domestic and foreign operations and attempt to assure that a fair, "arm's length" "transfer price" was assigned (on paper) to each transaction. But companies have a huge incentive to have their domestic operations pay too much or charge too little to their foreign operations for goods and services (for tax purposes only), thereby minimizing their U.S. taxable income. A May 1992 Congressional Budget Office report found that "[i]ncreasingly aggressive transfer pricing by . . . multinational corporations" may be one source of the shortfall in corporate tax payments in recent years compared to what was predicted in 1986.

We need to overhaul our rules governing international allocation of profits, to protect our tax base and our workers. The complex "transfer pricing" rules should be replaced with a much simpler formula approach, allocating profits based on the share of a company's worldwide sales, assets and payroll in the United States. Exactly how much revenue could be gained by international tax reforms is unclear—some estimates are on the order of $10-15 billion annually. *According to the Joint Committee on Taxation, just four current international corporate tax breaks will cost $35 billion over the next five years.** *Comprehensive reform in this area could raise at least that much.*

7. Curb tax breaks for runaway plants: A more narrow step than the broad reforms outlined in the previous point would be to limit current tax breaks that (1) allows companies to "defer" indefinitely U.S. taxes on unrepatriated income earned by foreign subsidiaries and (2) allows companies to use foreign tax credits for taxes paid to non-tax-haven countries to offset U.S. tax due on repatriated profits generated in a low- or no-tax foreign tax haven. These tax breaks, which encourage companies to move business activity overseas, could be disallowed in cases where goods are produced in overseas tax havens for U.S. sale, as provided in H.R. 2889. *5-Year Revenue Gain: $1 billion.*

8. Curb oil & gas loopholes: Oil and gas companies continue to be allowed to write off many of their capital costs immediately, and many can take deductions for so-called "percentage depletion"—

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*The corporate international tax expenditures highlighted by the Joint Tax Committee are: the exclusion of income of "foreign sales corporations" ($7.9 billion over five years); the deferral of income of controlled foreign corporations ($5.8 billion); the inventory property sales source rule exception ($20.5 billion); and the interest allocation rules exception for certain nonfinancial institutions ($1 billion).

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which has no connection with actual expenses. These special tax subsidies for oil and gas and other energy and mineral producers should be repealed. *5-Year Revenue Gain: $7.6 billion.*

9. Tax foreigners' interest at 5 percent: Interest earned by foreigners in the United States (on loans to American companies and the U.S. government) was exempted from U.S. tax in 1984. Typically, this interest income is not reported to foreigners' home governments either. As a result, the United States has become a major international tax haven. A five percent tax should be imposed on interest earned in the U.S. by foreigners. The tax could be waived if a foreign lender supplies the information necessary to report the interest income to the foreign home government. *5-Year Revenue Gain: $15 billion or more.*

10. Curb farm tax shelters: Unlike most other types of "tax-shelter" losses, farm "losses" can often be deducted against non-farm income, if a lenient "material participation" condition is met. Farm "losses" should not be allowed against unrelated income. *5-Year Revenue: $7 billion.*

11. Tax real estate like-kind exchanges: Normally, when someone sells appreciated property he or she must pay tax on the capital gain. But someone who sells rental real estate and later purchases other rental property can put off paying capital gains taxes on the sale indefinitely by pretending to have "exchanged" the properties. This special tax deferral for these so-called "like-kind exchanges" should be eliminated. (The change would not affect sales of personal residences.) *5-Year Revenue Gain: $2 billion.*

12. End a real estate refinancing loophole: Owners of business real estate can cash in their capital gains without tax by refinancing their properties. This is an enormous tax shelter that benefits wealthy real estate speculators. The rule should be that if real estate is refinanced for more than its original purchase price, the excess would be treated as a taxable event. (This would not apply to homes.) *5-Year Revenue Gain: $4 billion.*

13. Tax-exempt bonds for private purposes: In many circumstances, private companies can "borrow" the ability to issue tax-free bonds from state and local governments. Tighter limits on this misuse of state and local tax exemptions could raise many billions of dollars.

14. Reform the corporate and high-income Alternative Minimum Tax. The Alternative Minimum Tax is supposed to assure that all companies and wealthy individuals pay some significant federal income tax. But there are a number of weaknesses in the AMT that should be fixed.

The AMT base should be broadened, by eliminating deductions for interest payments to foreign lenders in tax havens, mortgage interest on second homes and on more than $200,000 in mortgage debt, and "company cars" (with minor exceptions). Executive fringe benefits should be subject to the AMT and exceptions to the "at risk" anti-tax-shelter rules should be eliminated. And any of the reforms outlined earlier that are not dealt with in reforming the regular income tax should be adopted at least for AMT purposes.

Unfortunately, the 1993 budget act substantially weakened the corporate alternative minimum tax, by boosting AMT depreciation write-offs. In addition, the 1993 act weakened the individual AMT by allowing double-dipping deductions for charitable donations of appreciated property (stocks, real estate, artworks, etc.) These were steps in exactly the wrong direction. *Repealing the 1993 changes along with other AMT reforms could raise tens of billions of dollars over five years.*

15. Corporate tax rate on large corporations: At 35 percent, the top corporate tax rate is now 4.6 points below the top personal tax rate. During the debate over the 1993 budget act, some small-business lobbyists complained bitterly that this discrepancy was unfair. *Increasing the top corporate rate to the same level as the top personal rate would raise about $14 billion annually–and more than $60 billion over five years.*