

**Tax Policy Center**  
Urban Institute and Brookings Institution

**A PRELIMINARY ANALYSIS OF THE 2008  
PRESIDENTIAL CANDIDATES' TAX PLANS**

The Tax Policy Center\*

An Updated Analysis is available

[http://www.taxpolicycenter.org/taxtopics/presidential\\_candidates.cfm](http://www.taxpolicycenter.org/taxtopics/presidential_candidates.cfm)

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## EXECUTIVE SUMMARY

Tax and fiscal policy will loom large in the next president's domestic policy agenda. Nearly all of the tax cuts enacted since 2001 expire at the end of 2010. The individual alternative minimum tax (AMT) threatens to ensnare tens of millions of Americans in a web of pointless complexity and higher taxes, but a permanent fix palatable to both political parties has proven elusive. And large projected increases in spending on Social Security, Medicare, and Medicaid will put unprecedented demands on federal government revenue sources in the coming decades.

Fundamental reform of our tax system is one way to resolve these problems, but because reform creates both winners and losers, the leading presidential candidates have not addressed it seriously. Nonetheless, both candidates have proposed major changes to the nation's tax laws. Senator McCain would permanently extend the 2001 and 2003 tax cuts, increase deductions for taxpayers supporting dependents, reduce the corporate income tax rate, and allow immediate deductions for the cost of certain short-lived capital equipment. Senator Obama would permanently extend certain provisions of the 2001 and 2003 tax cuts primarily affecting taxpayers with incomes under \$250,000; increase the maximum rate on capital gains and qualified dividends; and enact new and expanded targeted tax breaks for workers, retirees, homeowners, savers, students, and new farmers. Senator McCain proposes to extend and expand permanently the AMT "patch" that has prevented most individuals and families with incomes below \$200,000 from being affected by the tax, and in our interpretation of his proposal, Senator Obama would also extend the patch. Each candidate would also increase the estate tax exemption and reduce the estate tax rate compared with current law in 2011 and beyond, although Senator McCain would cut the tax much more than Senator Obama. Finally, each candidate promises to broaden the tax base and reduce corporate loopholes. McCain lists eight breaks for oil companies as targets but, other than that, is short on details for his pledge to eliminate "corporate welfare." Obama identifies a variety of steps, including basis reporting for capital gains, taxing carried interest as ordinary income, and enacting sanctions on international tax havens that don't cooperate with enforcement efforts, but he would also need additional as-yet-unspecified policies to achieve his revenue target for base broadening.

Although both candidates have at times stressed fiscal responsibility, their specific non-health tax proposals would reduce tax revenues by \$3.6 trillion (McCain) and \$2.7 trillion (Obama) over the next 10 years, or approximately 10 and 7 percent of the revenues scheduled for collection under current law, respectively. Furthermore, as in the case of President Bush's tax cuts, the true cost of McCain's policies may be masked by phase-ins and sunsets (scheduled expiration dates) that reduce the estimated revenue costs. If his policies were fully phased in and permanent, the ten-year cost would rise to \$4.0 trillion, or about 11 percent of total revenues.

Both candidates argue that their proposals should be scored against a "current policy" baseline instead of current law. Such a baseline assumes that the 2001 and 2003 tax cuts would be extended and the AMT patch made permanent. Against current policy, Senator Obama's proposals would raise \$300 billion, an increase of 1 percent, and Senator McCain's proposals lose \$1.0 trillion (if fully phased-in and permanent), a decrease of roughly 3 percent. Senator McCain has stressed that deficits should be closed by spending cuts, but policies he identifies, such as limiting earmarks, would offset only part of the revenue losses attributable to his tax

plan. As noted, both candidates may be overoptimistic in their revenue targets for closing tax loopholes—Obama probably more than McCain.

The two candidates' plans would have sharply different distributional effects. Senator McCain's tax cuts would primarily benefit those with very high incomes, almost all of whom would receive large tax cuts that would, on average, raise their after-tax incomes by more than twice the average for all households. Many fewer households at the bottom of the income distribution would get tax cuts and those whose taxes fall would, on average, see their after-tax income rise much less. In marked contrast, Senator Obama offers much larger tax breaks to low- and middle-income taxpayers and would increase taxes on high-income taxpayers. The largest tax cuts, as a share of income, would go to those at the bottom of the income distribution, while taxpayers with the highest income would see their taxes rise.

The impact of the tax code on economic activity under each candidate's policies would differ in several important ways. Under Senator McCain's proposed policies, the top marginal rates (35 percent on individual income and 25 percent on corporate income) would be significantly lower than under Senator Obama's plan (39.6 and 35 percent, respectively). McCain's reduced individual and corporate rates could improve economic efficiency and increase domestic investment, but the larger future deficits would reduce and could completely offset any positive effect. In contrast, Senator Obama's proposed new tax credits could encourage desirable behavior, particularly if the childless EITC and payroll tax rebate encourage additional labor supply among childless low-income individuals. However, he would also direct new subsidies at an already favored group—seniors—and an already favored activity—borrowing for housing—which could probably be better directed elsewhere.

Both candidates have proposed to change the tax treatment of health insurance in important ways. This analysis does not address those proposals, but we expect to evaluate both plans soon.

Section I of the report describes how we obtained information about the candidates' tax plans and how we performed our modeling and analysis. In section II, we outline the major tax proposals put forth, and in section III, we discuss their implications for the revenue raised and taxpayer economic activity. Section IV looks at their effect on the distribution of the tax burden.



## **I. HOW WE DID OUR ANALYSIS**

One challenge facing anyone who wants to estimate the effects of candidates' tax plans is that no one—not even inside the campaigns—knows exactly what the proposals are. Stump speeches and campaign white papers are often short on the technical details needed to analyze the proposals fully. In addition, the candidates' plans are often works in progress that change during the campaign.

However, it is important for the public to understand as much as possible how a candidate's tax proposals will affect them, their neighbors, and the broader economy. Thus, we have filled in the blanks, making assumptions about key missing details. Some of the details have been validated by campaigns, but some have not. We will update our analysis when we learn about revisions, modifications, or corrections. The details of the policies we model are clearly specified in the descriptions that follow.

Particular uncertainty surrounds the health proposals. Senator Obama has not specified whether he will implement his subsidies for health insurance as a tax credit or direct spending program, while Senator McCain has said that his proposal is a tax credit. To allow an apples-to-apples comparison, we will compare both McCain's and Obama's health plans as if they were tax credits, but will do so outside our main analysis of the proposals (and do not include the health plans in this preliminary analysis).

In estimating the revenue and distributional effects of tax policies, we must specify a baseline—a set of tax laws that are the yardstick for comparison. What the right baseline should be is not obvious. Congressional scorekeepers use a current law baseline, in which the tax cuts expire as scheduled after 2010 and nothing is done about the AMT. The administration's baseline assumes all of the president's tax proposals are enacted, including permanent extension of the tax cuts, but only a temporary fix for the AMT. We estimate the cost of the plans against two baselines: current law (as described above) and extended law, in which the Bush tax cuts are extended and the AMT patch is extended.

We also estimate revenue as a share of GDP, which is independent of baseline, for each plan. This measure indicates the level of government that could be sustained under each candidate's tax plans over the long term. Historically, tax revenues have averaged about 18 percent of GDP. (The president's fiscal 2009 budget projects receipts of 18.8 percent of GDP in 2013.) Senator McCain's proposals, if fully phased in by the end of his first term, would reduce revenues to about 17.6 percent of GDP, while Senator Obama's proposals would cut revenues less—to about 18.5 percent of GDP.

## **II. DESCRIPTION OF THE PLANS**

In this section, we outline the two candidates' proposed tax plans. As noted, we sometimes had to make assumptions to model the proposals. We assume that all proposals would take effect January 1, 2009, unless the campaign has specified an alternative schedule. Of course, the

legislative process might delay the effective date for some proposals (as well as make other changes). Table 1 summarizes the major elements of each plan.

#### *A. SENATOR MCCAIN'S PLAN*

**Extension of the 2001 and 2003 tax cuts.** Almost all of the tax cuts enacted during the past eight years are set to expire at the end of 2010. (The major exception is the Pension Protection Act of 2006, which permanently expanded tax-favored retirement savings accounts and the saver's credit.) The sunset means that in 2011 the 10 percent tax bracket will disappear; the 28, 33, and 35 percent tax rates will increase to 31, 36, and 39.6 percent, respectively; the capital gains rates will increase from 0 and 15 percent to 8 or 10 and 18 or 20 percent (with the lower rate applying to long-held assets); the child credit will shrink to \$500 per child and be nonrefundable for most taxpayers; the top of the 15-percent bracket and the standard deduction for married couples will no longer be set to double the amounts for single filers; the top estate tax rate will increase to 55 percent and the exemption will decline to \$1 million; and numerous other provisions will revert to their previous form or expire. Senator McCain has proposed making the 2001 and 2003 tax cuts permanent (except for the estate tax, which he would modify as described below).

**Extension and indexation of the 2007 AMT patch.** Individuals must compute their taxes under both the regular tax and the alternative minimum tax. If the alternative minimum tax exceeds the regular tax, taxpayers must pay the higher amount. The AMT requires taxpayers to add a number of preference items (including personal exemptions and certain deductions) to their taxable income, but they may deduct a special AMT exemption. Since 2001, the AMT exemption has been temporarily increased for a year or two at a time to prevent large numbers of taxpayers from becoming subject to the tax. In 2007, the exemption was \$66,250 for joint returns and \$44,350 for singles and heads of household. But, in 2008, the AMT exemption is set to return to its 2000 level—\$45,000 for couples and \$33,750 for singles and heads of household—and the number of taxpayers subject to the AMT is projected to increase from 3.5 million in 2007 to 26.5 million in 2008.

Senator McCain proposes to extend and increase the higher AMT exemption amounts set in 2007 and allow individuals to claim personal nonrefundable credits against the AMT. The 2001 tax cuts, which Senator McCain would make permanent, allowed refundable credits against the AMT. Between 2009 and 2013, the AMT exemption amount would be indexed for inflation. After 2013, the exemption would be increased by inflation plus 5 percent until the joint exemption reaches \$143,000, at which point the rate of increase will revert to inflation only.

Although Senator McCain does not plan to repeal the individual AMT, he would allow taxpayers to avoid it by electing to be taxed under an optional alternative tax system (see box 1).

**Dependent exemption increase.** Taxpayers may claim exemptions for themselves, their spouses (on joint returns), and each dependent (usually children, but also certain other relatives and household members supported by the taxpayer). The exemption is \$3,500 in 2008 and is indexed for inflation going forward. Senator McCain has proposed increasing the dependent exemption—but not the personal exemption for taxpayers themselves—by \$500 each year beginning in 2010



until it reaches \$7,000 in 2016, after which it would again be indexed for inflation.<sup>1</sup> Because current law indexes the exemption for inflation, the proposed \$7,000 exemption in 2016 will not be twice its level scheduled under current law but only two-thirds higher. (We project that the personal exemption will be \$4,200 in 2016 under current law.)

Married couples filing a joint return reporting adjusted gross income of \$50,000 or less would be eligible for the \$7,000 exemption immediately (in 2009). The higher exemption phases out at a rate of \$100 for each \$1,000 (or fraction thereof) in excess of \$50,000, but not below the level set by the unrestricted phase in available for all taxpayers. For married couples, the \$7,000 threshold would not change until 2017 (that is, it would not be indexed for inflation until then). Thus, although this provision is sometimes described as a doubling of the personal exemption, that is true only in the first year, and then only for lower-income married couples.

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<sup>1</sup> Our analysis assumes the projected current-law exemption of \$3,600 in 2009 with subsequent increases to \$4,000 in 2010 and then \$500 each year through 2016.

## Summary of the Major Provisions of the McCain and Obama Tax Plans

	John McCain	Barack Obama
<b>2001/2003 Tax Cuts</b>	Make permanent all provisions other than estate tax repeal	Make permanent select provisions, including child credit expansions; 10, 15, 25, and 28 percent rates; changes to tax implications of marriage
<b>Estate Tax</b>	Make permanent estate tax with \$5 million exemption and 15 percent rate	Make permanent estate tax with \$3.5 million exemption and 45 percent rate
<b>AMT</b>	Extend and index 2007 AMT patch, further increase exemption by 5 percent in excess of inflation after 2013 (temporarily)	Extend and index 2007 AMT patch
<b>New Tax Cuts</b>	<p>Increase the dependent exemption by two-thirds (phased in)</p> <p>Reduce the maximum corporate income tax rate from 35 percent to 25 percent (phased in)</p> <p>Allow first-year deduction of 3- and 5-year equipment and deny interest deduction (expires)</p> <p>Convert R&amp;D credit to 10 percent of wages incurred for R&amp;D, make permanent</p> <p>Suspend federal gas tax for summer 2008</p>	<p>Refundable "Making Work Pay Credit" of 6.2 percent of up to a maximum of \$8,100 of earnings</p> <p>Refundable "Universal Mortgage Credit" of 10 percent of mortgage interest for nonitemizers</p> <p>Eliminate income tax for seniors making less than \$50,000 per year</p> <p>Extend childless EITC phase-in range, increase phase-out threshold</p> <p>Increase EITC phase-in rate to 45 percent for families with three or more children</p> <p>Increase to \$5,000 the add-on to EITC phase-out threshold for married filers</p> <p>Make CDCTC refundable and increase maximum credit rate to 50 percent.</p> <p>Make saver's credit refundable and change formula to 50 percent match up to \$1,000 of contributions</p> <p>Make permanent R&amp;D credit and renewable energy production tax credit</p> <p>Mandate automatic 401(k)s and automatic IRAs</p> <p>Increase Hope credit: 100% match rate up to \$4,000</p>
<b>Health</b>	Replace exclusion from income for employer sponsored insurance with refundable credit of \$2,500 for individuals and \$5,000 for families	Income-related subsidies for health insurance
<b>Tax Increases</b>	<p>Repeal domestic production activities deduction</p> <p>Eliminate oil and gas loopholes</p> <p>Unspecified corporate base broadeners</p>	<p>Increase maximum capital gains rate to 25 percent</p> <p>Tax carried interest as ordinary income</p> <p>Eliminate oil and gas loopholes</p> <p>Tax publicly traded financial parts. as C corps.</p> <p>Codify economic substance doctrine</p> <p>Reallocate multinational tax deductions</p> <p>Require information reporting of basis for gains</p>
<b>Simplification</b>	Create optional alternative tax with two rates and larger standard deduction and exemptions	Provide taxpayers with simple returns the option of pre-filled tax forms to verify and sign.

**Permanent estate tax cuts.** Current law reduces the estate tax in 2009 and eliminates it entirely in 2010, but only for that one year. Expiration of the 2001 tax cuts in 2011 will return the estate tax exemption to \$1 million and the top estate tax rate to 55 percent. Senator McCain has called for permanent reduction of the tax in 2010 by increasing the estate tax exemption from its scheduled 2009 level of \$3.5 million to \$5 million and reducing the tax rate from 45 percent to 15 percent. We assume the exemption remains specified in nominal terms (i.e., is not automatically adjusted for inflation), as it is under current law. McCain would also make permanent the current deduction for estate taxes paid to states rather than restore the more generous credit that used to apply. We assume no change in the gift tax.

**Corporate income tax reductions.** Corporations currently pay tax at rates of 15, 25, 34, and 35 percent and are also subject to 3 and 5 percent surtaxes in certain income ranges. Senator McCain proposes to cut the maximum corporate income tax rate from 35 to 25 percent. McCain's plan would eliminate the 35 percent bracket immediately and phase down the 34 percent rate to 30 percent in 2010, 28 percent in 2012, 26 percent in 2014, and 25 percent thereafter. The surtaxes would also be eliminated immediately.

Under current law, businesses must depreciate equipment over time, deducting part of its value each year. Equipment is classified by the time period over which its cost must be depreciated (e.g., 3 years, 5 years, 7 years, 10 years, and so forth). Senator McCain proposes to allow businesses to immediately expense the full cost of three- and five-year business equipment purchased between 2009 and 2013. After 2013, businesses would again have to depreciate equipment over time. To prevent tax sheltering, the proposal would disallow the interest deduction for expensed equipment. However, it is not clear how such a policy would be implemented in practice because there often is no direct link between equity, debt, or cash-flow financing and equipment purchases.

**Repeal of domestic production activities deduction.** Under current law, U.S. companies may reduce taxable income attributable to qualifying domestic production activities. The deduction amount is increasing gradually to 9 percent of income in 2010, effectively reducing the maximum tax rate on such income from 35 to 32 percent. Senator McCain would repeal the domestic production activities deduction.

**Permanent extension and modification of the R&E credit.** Under current law, companies may claim a tax credit of 20 percent for certain research and experimentation expenditures above a base amount. The effective rate of subsidy on all expenditures has been estimated at between 3 and 5 percent. Senator McCain has proposed making the research credit permanent and equal to 10 percent of all wages spent on research and development.

**Elimination of preferential treatment of oil companies.** Under McCain's plan, several provisions benefitting oil companies would be repealed, including expensing of exploration and development costs, the 15-percent tax credit for enhanced oil recovery costs for tertiary wells, the exception to uniform capitalization rules for intangible drilling costs, and the special depreciable lifetimes for select oil company assets.

**Corporate base broadening.** Senator McCain has proposed broadening the corporate income tax base. In combination with the provisions targeting oil companies, the campaign claims these provisions would raise \$30 billion per year. Specific proposals to achieve this objective have not been specified so we cannot verify the revenue figure. Our analysis assumes their first-year revenue gains and projects them to grow at the same rate as GDP throughout the 10-year budget window.

**Gas tax holiday.** Senator McCain has called for a federal gas tax holiday in summer 2008. Even if enacted, the holiday would occur before the presidential election, so we exclude it from our analysis.<sup>2</sup>

### **Box 1. Optional alternative maximum tax**

Senator McCain has proposed to allow taxpayers to figure their taxes under an optional alternative tax system that would have two rates, a large standard deduction, and an increased personal exemption. A McCain economic advisor wrote in a post to *TaxVox* (the Tax Policy Center's blog) that he expects the proposal to be revenue-neutral, neither increasing nor decreasing federal tax revenues (Holtz-Eakin 2008).

The plan lacks sufficient details to model, but we also judge the notion of a revenue-neutral and optional alternative tax system as implausible. Taxpayers would tend to choose the alternative system only if they expected it to reduce their tax liability or reduce their compliance burdens enough to make additional taxes palatable. Although there is no hard evidence on how much people are willing to pay for simplicity, it is likely not a large amount. Indeed, if taxpayers were willing to pay higher taxes to simplify their return, they could do so under the current system simply by skipping all deductions, exemptions, and credits. Few, if any, taxpayers make this election. Furthermore, if the new alternative tax system does not offer significant tax cuts, having to figure taxes under two systems and estimate which one would be better would add complexity, not reduce it. An offsetting factor, however, would be a requirement that people choosing the alternative tax would have to use that alternative for a number of subsequent years before they could return to using the regular tax. Some taxpayers might make a costly choice to save taxes now but end up paying more tax in future years.

Both the Republican Study Committee and the presidential campaign of Senator Fred Thompson have proposed optional alternative taxes. We estimated that those plans would dramatically reduce revenues—by as much as \$6–7 trillion over the next decade compared with current law (Burman, Leiserson, and Rohaly 2008). Those proposals would disproportionately benefit those with very high incomes, making the tax system less progressive.

A simpler, fairer, and more pro-growth tax system would be a huge improvement over the current system, but it should replace the current system rather than further complicate an already

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<sup>2</sup> See “Quick Facts on the Gas Tax Holiday,” [http://www.taxpolicycenter.org/taxtopics/quick\\_gastax.cfm](http://www.taxpolicycenter.org/taxtopics/quick_gastax.cfm), for additional discussion of the economics of a gas tax holiday.

**Tax subsidies for health insurance.** Senator McCain has proposed replacing the current exclusion from income tax for health insurance provided by an employer with a refundable tax credit of \$2,500 for singles and \$5,000 for family coverage. Unlike the current exclusion, the credit would be available for both privately purchased and employer-provided insurance. We assume that the credit amounts would be indexed for inflation after 2009 using the CPI-U. (Alternative policy proposals have suggested indexing new health insurance credits and deductions to an index of medical prices, rather than overall prices as measured by the usually used CPI-U).

## ***B. SENATOR OBAMA'S PLAN***

**Partial extension of the 2001 and 2003 tax cuts.** Senator Obama has called for extending the tax cuts affecting the middle class while eliminating those benefitting the wealthiest Americans. According to the campaign, Obama would extend the child credit expansions; the changes to marriage bonuses and penalties; and the 10, 15, 25, and 28 percent income tax rates, as well as the lower tax rates on capital gains and qualified dividends for taxpayers in those four tax brackets. He would restore the 36 and 39.6 percent rates and increase the rate on capital gains and dividends for taxpayers in those brackets. To match the campaign's stated revenue targets, we assumed a rate of 25 percent for capital gains and qualified dividends.<sup>3</sup> Obama would also restore the phaseouts of personal exemptions and itemized deductions, but set the income threshold at \$250,000 for married couples filing jointly. As under current law, the thresholds for the phaseout of personal exemptions would be lower for singles and heads of households, but those for the phaseout of itemized deductions would not vary with filing status. The thresholds would be indexed for inflation as they are under current law. Senator Obama would also extend several smaller expiring tax cuts, including the adoption credit and the simplifications to the earned income tax credit. Certain other provisions would be modified, as described below.

**Extension and indexation of the 2007 AMT patch.** Senator Obama supports "fiscally responsible" AMT reform. Without further guidance as to what this means, we assume his plan would simply extend the policy in recent years, indexing AMT exemption amounts for inflation from 2007 levels and permanently allowing individuals to claim personal tax credits against the AMT.

**Freeze 2009 estate tax law.** Senator Obama's plan would permanently fix the estate tax law in its 2009 form: an exemption of \$3.5 million and a top rate of 45 percent. We assume the exemption would remain fixed in nominal terms as it is under current law and that the state death tax would remain deductible and not revert to a credit.

**Making Work Pay credit.** Senator Obama has proposed a new refundable tax credit for wage earners and the self-employed. His Making Work Pay credit would equal 6.2 percent of up to \$8,100 of earnings (yielding a maximum credit of approximately \$500). Spouses filing jointly

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<sup>3</sup> Under current law, the top tax rate on capital gains would increase from 15 percent to 20 percent in 2011 and qualified dividends would face ordinary income tax rates as high as 39.6 percent. Obama's plan would thus increase the maximum tax rate on gains from 20 percent to 25 percent and reduce that on qualified dividends from 39.6 percent to 25 percent.

would each claim the credit based on their own earnings.<sup>4</sup> To match the campaign's stated revenue targets, we assume the credit phases out based on adjusted gross income at a 5 percent rate beginning at \$75,000 (\$150,000 for couples). All thresholds would be indexed for inflation after 2009.

**Universal Mortgage credit.** Under current law, taxpayers who itemize their deductions may deduct mortgage interest. Senator Obama has proposed a refundable credit equal to 10 percent of mortgage interest for non-itemizers, up to a maximum credit of \$800 (indexed after 2009).

**New incentives for savings.** Senator Obama has proposed a set of programs that would change the structure of tax-favored retirement accounts and improve incentives to contribute to them. He would mandate automatic 401(k) plans for employers offering retirement plans. Automatic 401(k)s require individuals to opt out of their employer's retirement plan rather than to opt in, but do not change the individual's set of available options. Senator Obama would require employers who do not sponsor other retirement plans to offer access to automatic IRAs, which would allow workers to contribute to tax-favored IRA accounts via payroll deduction. If an employee does not either opt out or specify her own IRA account, the employer would automatically contribute a share of earnings to a designated employee account set up on the employee's behalf by a financial institution. Finally, Obama would modify the current nonrefundable saver's tax credit. The new saver's credit would be fully refundable and would equal 50 percent of qualified retirement savings contributions up to \$500 for an individual and \$1,000 for a couple (for a maximum credit of \$250 and \$500, respectively). The credit would phase out at a 5 percent rate when AGI exceeds \$32,500 for individuals and \$65,000 for couples. The credit thresholds would be indexed for inflation after 2009.

**American Opportunity Tax Credit.** The current Hope credit is a nonrefundable credit of 100 percent of the first \$1,200 of qualified higher educational expenses and 50 percent of the next \$1,200 up to a maximum of \$1,800 per student (in 2008). Qualifying expenses generally include tuition and fees for the first two years of a qualifying postsecondary education institution. Senator Obama has proposed making it a fully refundable, 100-percent tax credit for the first \$4,000 of qualifying higher education expenses and renaming it the American Opportunity Tax Credit. The credit would be computed using prior-year tax data and delivered directly to the higher education institution when a student enrolls. Students claiming the credit would have to perform 100 hours of community service upon completing their education. We assume this credit would retain all other features of the current Hope credit, including the phase-out thresholds and indexation of the maximum qualifying expenses. We further assume no changes in the lifetime learning credit and that the current tuition and fees deduction will expire as scheduled under current law.

**Expansion of the earned income tax credit.** Senator Obama has proposed several expansions to the earned income tax credit. He would increase the maximum amount of earned income on which the credit for childless workers is calculated from a projected \$5,910 in 2009 to \$6,300, \$6,800 in 2010, \$7,100 in 2011, and \$7,250 in 2012. The threshold at which the phaseout begins would be increased from \$7,390 in 2009 to \$9,825, \$10,875 in 2010, \$12,325 in 2011, and

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<sup>4</sup> For example, a couple in which each individual earns \$8,100 would qualify for \$1,000 in tax credits, while a couple with one spouse earning \$16,200 would receive only the \$500 individual credit.

\$14,500 in 2012 and then indexed for inflation going forward.<sup>5</sup> He would double the phase-in and phase-out rates for childless workers who pay child support from 7.65 to 15.3 percent.<sup>6</sup> Thus, their maximum tax credit would double from \$555 to \$1,110 in 2012. Obama would also increase the credit rate from 40 to 45 percent for taxpayers with three or more children (but keep the phaseout rate at 21.06 percent). Finally, the phase-out threshold for joint filers would be \$5,000 higher than for heads of household (up from \$3,100 under current law) and that amount would be indexed for inflation after 2009.

**Expansion of the child and dependent care credit.** The child and dependent care credit is a nonrefundable tax credit available to individuals paying for child care needed so they can either work, or look for work.<sup>7</sup> Senator Obama's tax plan would make the credit refundable and increase the maximum rate from 35 to 50 percent. It would also increase from \$15,000 to \$30,000 the threshold at which the credit rate begins to phase down and reduce the rate by 2 percentage points (rather than the current 1) for each \$2,000 or fraction thereof above that level. The minimum credit rate would remain 20 percent and would apply to taxpayers with income above \$58,000.

**Exempting seniors earning less than \$50,000 from income taxation.** Senator Obama would exempt seniors earning less than \$50,000 from income taxation. A tax unit would pay no income tax if the primary taxpayer (and the spouse for married couples) is age 65 or older and the tax unit's adjusted gross income, untaxed Social Security benefits, and tax-exempt interest totals less than \$50,000. Tax units entitled to a net refund from the government would remain entitled to that refund. The threshold would be the same for both single and married households and would not be indexed for inflation (so its value would erode over time). The eligibility threshold for seniors is a strict threshold—there is no phaseout.

**Permanent extension of the R&D credit and renewable energy production credit.** Senator Obama has proposed making permanent both the research credit and the renewable energy production credit.

**Miscellaneous revenue-raisers.** Senator Obama has proposed (1) taxing carried interest as ordinary income, (2) eliminating all oil and gas loopholes, (3) codifying the economic substance doctrine (requiring that transactions qualifying for tax benefits have economic justification beyond those benefits), (4) requiring publicly traded financial partnerships to pay the corporate income tax, (5) creating an international tax haven watch list of countries that do not share information returns with the United States (and potentially enacting sanctions against those countries), (6) imposing a windfall profits tax on oil and gas companies, (7) requiring information reporting of basis for capital gains, reallocating multinational tax deductions, and (8) closing loopholes in the corporate tax deductibility of CEO pay. Because not all provisions are identified, we cannot verify that revenue estimate but use it for 2009. We assume that the amount

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<sup>5</sup> Under current law, the EITC thresholds are rounded to the nearest multiple of \$10 in each year. For modeling convenience, we retain this practice during the years 2009 through 2012, even when it conflicts with the stated thresholds. The impact on the simulation results is negligible.

<sup>6</sup> We do not model the doubled EITC for childless workers who are noncustodial parents paying child support due to data limitations that limit the quality of the estimate. The cost of the provision is small relative to the others.

<sup>7</sup> In the case of married couples, both spouses must work or be looking for work to qualify except in the case where one spouse is a full-time student and the other works.

would grow at the same rate as GDP throughout the 10-year budget window. Combined with other as-yet-unidentified provisions, the campaign expects these provisions to raise \$76 billion in revenue each year.

**Excluded policies.** We do not model the following policies for which Senator Obama has stated support because of data limitations and/or insufficient detail about the policies that would be enacted: (1) permanent extension of the adoption credit; (2) creation of new incentives for first-time farmers; (3) elimination of capital gains taxes affecting start-up businesses; (4) creation of new incentives for small business investment; and (5) creation of an automated filing system for most taxpayers. The revenue and distributional consequences (by income) of these policies are small in relation to the other policies discussed.

**Box 2. Earnings subject to Social Security payroll tax**

In 2008, the first \$102,000 of earnings is subject to Social Security payroll taxes at rates of 6.2 percent on both employees and employers. The amount is indexed to inflation. (All earnings are also subject to Medicare payroll taxes at rates of 1.45 percent on employees and employers.) Senator Obama has spoken at times about subjecting high-income taxpayers to the Social Security tax, possibly with an exemption for earnings above the current cap but below a new threshold of \$250,000, as way to reduce long-term imbalances in the Social Security system. Combined with a top federal income tax rate of 39.6 percent (nearly 41 percent including the effect of the itemized deduction phaseout), the proposal could raise effective tax rates on labor income for high earners above 52 percent (and over 55 percent for residents of states with high income tax rates).

However, the Obama campaign has repeatedly insisted that the campaign has no specific policy to raise Social Security taxes on anyone. Thus, we have not analyzed this aspect of the Senator's plan. We did, however, examine the revenue and economic effects of a policy consistent with Senator Obama's statements on [our TaxVox blog](#).

### III. ECONOMIC ANALYSIS

There is some common ground between the two plans. Both candidates agree that the elements of the 2001 and 2003 tax cuts primarily affecting those with incomes below \$250,000 should be extended, that the estate tax should be substantially reduced but not repealed, and that the research credit should be made permanent (though Senator McCain would change the formula by which it is calculated). Both candidates would continue to limit the number of taxpayers affected by the AMT but would not repeal it.

However, the differences between the candidates' plans are large. For one thing, both have a back-to-the-future look to them—McCain continues major themes of the Bush administration (lower marginal tax rates, low taxes on capital) while Obama follows the Clinton administration approach of expanding targeted tax breaks for social policy objectives and introducing new tax breaks. Their distributional impacts differ greatly as well: Senator McCain's plan gives the



largest tax cuts taxes to high-income taxpayers, while Senator Obama's plan directs the largest cuts toward lower-income taxpayers.

This section considers the effects of the candidates' proposals on efficiency and simplicity, with some discussion of the effects of the specific provisions on progressivity. Section IV examines the effects on the distribution of tax burdens.

### ***A. SENATOR MCCAIN'S PLAN***

Senator McCain has proposed substantial tax cuts, offset only very partially by proposals to broaden the tax base. Some of these tax cuts would have positive economic benefits, but adverse effects of the resulting increased deficits may make the net effect of the plan economically harmful.

#### **1. INDIVIDUAL INCOME TAXES**

The most striking feature of Senator McCain's plan is the substantial cut in top marginal income tax rates relative to current law. Under current law, the maximum statutory individual income tax rate after 2010 would be 39.6 percent and the maximum statutory corporate income tax rate would be 35 percent. McCain's proposed policies would drop the top individual and corporate rates to 35 and 25 percent, respectively. Cutting the maximum tax rates reduces the economic distortions taxes create and thus enhances economic efficiency. With lower individual and corporate rates, taxpayers have less incentive to engage in tax-preferred behavior (such as borrowing to buy bigger homes or taking compensation in tax-free fringe benefits instead of wages on the individual side, or investing in tax-favored activities for companies). Taxpayers may also increase hours of work and saving, although these effects are likely to be small. At the same time, McCain's reductions in the top marginal tax rates would make the tax system less progressive.

The reduction in the top marginal rate on individual incomes comes as part of Senator McCain's proposal to permanently extend the 2001 and 2003 tax cuts. The full cost of that extension would be nearly \$1.6 trillion over ten years (table R1). These tax cuts encompass an array of provisions, including reduced marginal rates, reduced rates on capital gains and qualified dividends, expansions in the child tax credit, and reduced taxation of married couples compared with singles. Lower marginal rates would improve economic efficiency and lead to higher incomes in the long run, but expanding the child credit does not improve economic incentives. Lower capital gains rates reduce lock-in to existing investments, but also encourage increased tax sheltering by converting ordinary income to capital gains. Lower dividend tax rates partially offset the adverse effects of taxing corporations more heavily than other businesses, but also provide large windfalls to investments in corporations that currently pay very low effective tax rates. Both capital gains and dividends are highly concentrated among upper income taxpayers.

**Table R1**  
**Senator John McCain's Tax Proposals**  
**Impact on Tax Revenue, 2009-18**

	<b>2009-13</b>	<b>2009-18</b>
(1) Make permanent all provisions of the 2001 and 2003 tax cuts other than estate tax repeal, including the reduced marginal tax rates, the marriage penalty relief, and the expanded child credit.	-528.6	-1,552.9
(2) Index AMT exemption for inflation permanently, increase by inflation plus 5% annually beginning in 2014 until the joint exemption surpasses \$143,000, and allow personal nonrefundable credits against the AMT.	-337.6	-1,109.5
(3) Increase estate tax exemption to \$5 million (unindexed), cut rate to 15%.	-85.2	-338.7
(4) Increase dependent exemption by \$500 annually between 2010 and 2016 and index for inflation thereafter. Accelerate increase for joint tax units.	-43.7	-185.0
(5) Reduce corporate income tax rate to 30% in 2010-11, 28% in 2012-13, 26% in 2014, and 25% thereafter.	-231.0	-734.7
(6) Repeal domestic production activities deduction.	43.8	97.6
(7) Allow expensing of all 3-year and 5-year business equipment. Deny interest deductions for expensed equipment. Sunset after 2013.	-92.5	-18.0
(8) Permanently extend and modify the R&D credit.	-51.5	-133.1
(9) Eliminate corporate welfare. Unverifiable campaign-provided revenue estimate	157.8	364.8
<b>Total of all provisions</b>	<b>-1,168.5</b>	<b>-3,609.7</b>
Addenda:		
Total of all provisions fully phased in	-1,426.2	-3,984.5
Net revenue impact against tax cuts extended, AMT-patched baseline	-216.1	-615.0
Net revenue impact against tax cuts extended, AMT-patched baseline fully phased in	-473.8	-989.9
Federal tax revenue as a share of GDP	18.0	17.9
Federal tax revenue as a share of GDP fully phased in	17.7	17.7

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

For more detailed tables, see

<http://www.taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=266>

Senator McCain would also permanently extend the AMT patch. This provision would substantially reduce the number of taxpayers affected by the AMT compared with current law, simplifying their tax calculations and frequently lowering the marginal tax rates they face and thereby reducing the economic cost of the tax. But the provision is quite expensive: federal tax revenues would fall by about \$1.1 trillion over 10 years. Furthermore, reductions in AMT liability also predominantly benefit higher-income taxpayers (See Burman, 2007).

Senator McCain proposes a two-thirds increase in the dependent exemption. This would reduce taxes for many taxpayers supporting dependents, but would provide no benefit for the many low-income filers who have no taxable income or for high-income filers subject to the AMT. Indeed, the proposal would subject more families to the AMT even with the proposed higher AMT exemption because personal exemptions reduce regular tax liability but are disallowed under the AMT and therefore do not affect liability. Assuming the proposed phase-in schedule, the proposal would cost approximately \$185 billion over the next 10 years. If the full increase was made immediately, the cost would jump by nearly half to about \$265 billion over the 10-year period.

## **2. CORPORATE TAXES**

Senator McCain would reduce corporate tax rates, temporarily allow expensing for some investments, and make the research and experimentation credit permanent. He would partially offset the revenue loss of these proposals by reducing business tax preferences.

The reduction in statutory tax rates for the corporate income tax rate would cost approximately \$700 billion over ten years if phased in as the McCain campaign has suggested; the cost would rise to \$1 trillion if it were enacted immediately. The top U.S. corporate income tax rate (including the effect of state corporate income taxes) is higher than the tax rates in most of our major trading partners, but other countries include a larger share of corporate economic income in the tax base, so their effective rates are not that different. As a share of GDP, the United States collects less revenue from corporate income tax than most of our trading partners. In recent years, other countries have been lowering their corporate tax rate and broadening the base and similar changes in the United States could be beneficial. A lower corporate tax rate would encourage multinational corporations to invest more in the United States and, for a given amount of investment, to report a larger share of their worldwide taxable income to the United States instead of foreign treasuries.

In addition to corporate rate cuts, Senator McCain has proposed expensing for all three- and five-year business equipment, while denying interest deductions on that equipment.<sup>8</sup> If made permanent and extended to include all business investment, this would represent a radical change in tax policy, converting the base of the corporate tax from income to consumption by exempting

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<sup>8</sup> It is not clear how the interest deduction limitation would be implemented. If the limit applies only to interest on loans that can be directly traced to three- and five-year equipment investment, as is done to enforce the limits on consumer interest deductions, then businesses will be able to skirt the limits by carefully attaching borrowing to depreciable investment, such as longer-lived equipment and real estate, and financing short-lived assets out of retained earnings (just as homeowners finance car purchases with deductible home equity loans). For a limit to be effective, explicit rules would have to reduce interest deductions based on the share of assets that a company expenses.

the normal return to investment. Under Senator McCain's proposal, the expensing would sunset after five years. We estimate the proposal will cost only about \$20 billion over the next ten years, as the large up-front costs are partially offset by revenue gains from lower depreciation deductions after the provision expires. If the sunset is deemed credible, the revenue loss could be larger as investors accelerate capital purchases to take advantage of expensing. If the provision does not sunset, the 10-year cost rises to over \$100 billion.

Senator McCain would partially offset the revenue loss from the lower corporate tax rate, expensing, and increasing and permanently extending the research and experimentation credit with other proposals that would broaden the corporate tax base. He has proposed repeal of the domestic production activities deduction, which would remove a major economic distortion in the corporate tax. (Clausing 2004) The domestic production activities deduction provides a lower effective tax rate for selected activities (defined as domestic manufacturing) at the expense of other income-producing businesses (services). There is no economic justification for favoring some business activities at the expense of others, so eliminating this provision would increase economic efficiency. Repeal of the domestic production activities deduction would raise approximately \$100 billion over the next ten years. Senator McCain also proposes to eliminate a number of tax preferences for domestic oil and gas production and to eliminate other, unspecified, corporate loopholes.

### **3. THE ESTATE TAX**

Senator McCain's proposal to reduce the estate tax rate to 15 percent and increase the exemption to \$5 million would reduce estate tax revenue by approximately \$340 billion over 10 years, more than 90 percent of the revenue that the tax would raise under current law. It would also reduce the extent to which the estate tax backstops the income tax (that is, taxing assets that might have escaped income tax as they accumulated because of careful tax planning or loopholes, including the exemption of capital gains on assets transferred at death).

The estate tax has ambiguous effects on working and saving. The tax may discourage some wealthy people who care about their heirs from saving or working by reducing the size of after-tax bequests. Others, however, may have a target amount of wealth they want to transfer, in which case they would need to save more to offset the expected tax liability. Further, the tax may encourage some potential heirs to work and save more because they are less able to live well off the proceeds of inherited wealth (for discussion, see Burman, Gale, and Rohaly 2005). On balance, the proposal is likely to have very small effects on work effort, saving, or overall economic performance. It would, however, reduce the progressivity of the tax system because only the richest estates now pay estate tax. Compared with leaving the 2009 rates and exemptions in place, near repeal of the tax as Senator McCain has proposed would disproportionately benefit a very small group of extremely wealthy individuals.

### **4. LONG-TERM CONSEQUENCES**

The consequences of all these proposals for economic efficiency and the distribution of economic burdens depend critically on how the measures are financed. To the extent that

individual and corporate marginal tax rate reductions are deficit-financed (that is, the government simply borrows more), the positive effects of lower tax rates will be offset by the costs of increased government debt. More government debt eventually translates into higher interest rates, which discourage business investment and consumers' demand for homes and such durable goods as automobiles, or, alternatively, into increased debt owed to foreigners, which mortgages the nation's long-term economic future. And if swelling deficits are closed by future tax increases rather than spending cuts, we impose much greater economic costs of taxation on our children and grandchildren than they would face if we do not enact tax cuts today.

If growing deficits eventually require draconian spending cuts—a stated goal of those who adhere to the “starve the beast” theory of government—then vulnerable populations may lack essential services; critical infrastructure investments for roads, bridges, and dams may be deferred; and the national defense may suffer.

### ***B. SENATOR OBAMA'S PLAN***

Senator Obama has also proposed substantial tax cuts and would significantly reduce federal tax revenues. The cuts are primarily aimed at reducing burdens on low- and middle-income taxpayers and promoting specific social policies regarding work, saving, and higher education. By many measures, the distribution of income has become much less equal over the past 20 years and the recent tax cuts have exacerbated that trend. The distribution of after-tax income has become even more unequal than the distribution of before-tax income. The Obama proposal tries to buck that trend by making the tax system much more progressive (as detailed in the next section).

However, it does so at the cost of higher tax rates and additional complexity. There are substantial new tax subsidies for education, child care, work, homeownership, and saving, and most senior citizens would be exempt from the income tax. The plan would maintain the estate tax with a \$3.5 million exemption and a top rate of 45 percent, a substantial cut from current law but less generous than Senator McCain's proposal. Tax credits for research and renewable energy would be made permanent.

Many provisions in Obama's plan share a common shortcoming in their use of phaseouts to limit their benefits and constrain revenue costs. Phaseouts gradually reduce tax benefits over a range of income and thus increase the effective marginal tax rate on taxpayers in that range. To the extent that higher tax rates affect behavior—inducing people to work fewer hours or save and invest less—the phaseouts adversely affect economic activity and growth. Furthermore, phaseouts add significant complexity to the tax code, making it more difficult for taxpayers to determine how much they owe and harder to understand how the tax system works.

Senator Obama does not rely on phase-ins and sunsets to limit the revenue cost of his proposals as Senator McCain would do. But, like McCain, Obama counts on a large amount of very uncertain revenue from a long list of revenue offsets—about \$78 billion per year (table R2). (Both candidates probably overstate the revenue they would get from offsets but McCain's target is a more modest \$30 billion.)

**Table R2**  
**Senator Barack Obama's Tax Proposals**  
**Impact on Tax Revenue, 2009-18**

	<b>2009-13</b>	<b>2009-18</b>
(1) Make permanent the EGTRRA child credit expansions, marriage bonus/penalty adjustments, 10/15/25/28% rates, and 0/15% rates on capital gains and dividends for select taxpayers; increase Pease and PEP thresholds.	-387.3	-1,098.9
	140.5	222.5
(2) Restore PEP/Pease with the increased thresholds in 2009-10, restore the 36/39.6% rates, and create a third capital gains and dividends rate of 25% for taxpayers in the 36 and 39.6% brackets		
(3) Extend and index the 2007 AMT patch	-364.7	-1,139.6
(4) Freeze 2009 estate tax law (exemption not indexed)	-22.9	-162.4
(5) Create "Making Work Pay Credit"	-331.2	-727.6
(6) Create "Universal Mortgage Credit"	-53.1	-123.0
(7) Mandate automatic 401(k)s and automatic IRAs, expand saver's credit	-94.1	-206.97
(8) Create "American Opportunity Tax Credit"	-59.4	-141.9
(9) Expand earned income tax credit	-19.6	-47.4
(10) Expand child and dependent care tax credit	-10.8	-23.5
	-25.0	-52.9
(11) Exempt seniors earning less than \$50,000 from income taxation		
(12) Make permanent the R&D and renewable energy production credits	-56.6	-155.1
(13) Revenue-raisers	399.7	924.1
Unverifiable campaign-provided revenue estimate		
<b>Total of all provisions</b>	<b>-884.5</b>	<b>-2,732.9</b>
Addenda:		
Net revenue impact against tax cuts extended, AMT-patched baseline	68.0	261.7
Federal tax revenue as a share of GDP <sup>1</sup>	18.4	18.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

(1) In official budget estimates the expansion of refundable credits would increase outlays rather than reduce revenues. Since we do not score outlays, we include the effect as a reduction in revenue in these tables.

For more detailed tables, see

<http://www.taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=266>

## 1. INDIVIDUAL INCOME TAXES

In 2009 and 2010, high-income taxpayers would face higher marginal tax rates on both ordinary income and capital gains and dividends than under current law. From 2011 on, the proposal primarily undoes the Bush tax cuts for high-income taxpayers. Tax rates on capital gains would rise while those on dividends would fall. The loophole closers would also primarily affect high-income taxpayers. Those changes would all affect economic choices about work, saving, and investment, potentially worsening economic outcomes. Although evidence is mixed on how much high-income taxpayers react to increases in their tax rates, most research has found only relatively small permanent reductions in income, but that taxpayers with the highest incomes respond more to tax changes than those with lower income and they have more ability to shift income to avoid temporarily high tax rates.

Many of Senator Obama's proposals would reduce taxes or increase refundable credits for low-income households. In general, such provisions make the tax system more progressive by shifting resources toward poorer workers and families. Because most of them would also affect after-tax wage rates or the net cost of working, saving, and attending school, they could have marked effects on work patterns and other behavior, although both the size of any changes and their net effect across the whole population are highly uncertain.

The Making Work Pay credit is intended to offset some of the regressivity of the Social Security payroll tax and encourage low-income people to work, but it does so at a substantial revenue cost—\$728 billion over 10 years. Because most workers earn more than \$8,100 annually, most of the revenue loss would go to taxpayers who receive no incentive to work more. A credit that was targeted more toward low-income workers would provide a more cost-effective work incentive. And because the phaseout of the credit increases marginal tax rates for those workers in the phaseout range, it might actually give those workers an incentive to work less. On efficiency grounds, the money would probably be better spent reducing marginal tax rates overall or reducing the deficit.

The Universal Mortgage Credit could be an improvement over current law if it replaced existing housing subsidies, which are inefficient and poorly targeted. But adding a new credit to the already extensive list of tax incentives for homeowners would compound the current inefficiency by encouraging even more investment in housing at the expense of higher-yielding business investments. The mortgage interest deduction is already among the largest subsidies in the tax code—worth \$95 billion in 2008—and the universal mortgage credit would add another \$13 billion subsidy. In addition, some taxpayers who do not use tax software or paid preparers might find it difficult to decide whether to forgo itemizing deductions to claim the new credit.

The proposal to exempt seniors earning under \$50,000 from income tax is poorly designed according to its current description and creates inequity between older and younger taxpayers with the same income. As we understand it, the proposal contains a “cliff:” filers with income just below \$50,000 would owe no income tax, but those with income just above that level could owe substantial tax. This would create substantial disincentives for seniors near the income threshold to work or otherwise earn income. Phasing out the benefit over a range of income would correct this flaw but would extend the benefit of the exemption to taxpayers at higher

income levels and thus raise the revenue costs (assuming no behavioral response to the “cliff”). And phasing out the benefit only reduces work disincentives since the phaseout itself increases effective marginal tax rates on affected taxpayers and could therefore reduce their willingness to earn more income.

The proposal also raises concerns about fairness. Under current law, most senior citizens pay no income tax because only a portion of Social Security benefits are subject to tax, and only for taxpayers with incomes above a threshold. In addition, senior citizens may claim an additional standard deduction. Nobody age 65 and over whose income comes entirely or almost entirely from Social Security is subject to income tax. The proposal would actually exempt comparatively well off, though not affluent, senior citizens from tax and give them a benefit not generally available to working Americans. Given the large pending increases in public spending on senior citizens due to the forthcoming retirement of the baby boomers, it seems inappropriate to target special income tax breaks to this group. Furthermore, the proposal helps only those low-income seniors who currently pay income taxes; those too poor to owe any tax—arguably those most in need—would get no benefit.

Obama would expand the EITC in three ways, all of which would have effects on people’s behavior. Extending the EITC phase-in range and phaseout threshold for childless workers would effectively increase after-tax wages for those with earnings below the threshold, which should encourage them to work more. At the same time, the phaseout range would extend further up the income scale and thus raise marginal tax rates for more childless workers, potentially leading them to work less. Similar effects could affect families with three or more children, for whom Obama would increase the EITC phase-in rate to 45 percent. The higher credit percentage would encourage more work by lower earners but the extended phaseout range could depress work effort. Finally, Obama’s proposal to extend the phaseout range for joint filers to \$5,000 more than that for other workers would only shift the income range over which the credit phases out, thus changing which couples face higher marginal tax rates in that range. Economic theory suggests all of those behavioral effects would change work patterns among affected workers but empirical studies have found significant effects only among secondary workers and then only in their decision to work, not how much to work. The main impact of all three proposed EITC expansions would be the increased after-tax income for affected workers and the consequent increase in progressivity of the income tax.

Senator Obama’s plan to make the child and dependent care tax credit refundable, to increase the credit rate to 50 percent, and to change the way in which the rate phases down to 20 percent would provide significantly more assistance to low-income families who need childcare to work or attend school. The greatest effect would likely be the effective increase in after-tax wages net of childcare costs for the poorest workers, who could get the credit for the first time because of its becoming refundable. Furthermore, the credit’s impact on wages net of work costs could have a significant effect on the work effort of secondary workers, who, as noted above, have been found to be more responsive to marginal after-tax wage changes. This provision could thus lead to increased economic output as well as make the income tax more progressive by providing increased credits to low-income workers.



Turning the currently non-refundable saver's credit into a refundable credit would encourage low-income households to save more by boosting the effective return to their saving. The phaseout of the credit would, however, raise effective marginal tax rates for many middle-income taxpayers with potential adverse behavioral effects. Similarly Obama's proposed conversion of the Hope credit to a larger, refundable credit would extend educational assistance to low-income students, making it easier for them to afford college and thus encouraging attendance, but again, the credit's phaseout would boost marginal tax rates for affected taxpayers.

## **2. CORPORATE TAXES**

Obama's proposal to make permanent the R&D credit and the renewable energy production credit would make it easier for firms to make investment decisions because they would no longer have to worry each time the credits approached their expiration. Both credits encourage particular behavior that Congress has deemed worthwhile and the change would likely increase both the amount of business investment and development of more renewable energy sources.

The two sets of revenue-raisers that Obama has proposed would raise taxes on corporations and individuals engaging in particular activities and thus might cause them to change what they do. To the extent that the provisions close loopholes in the current tax system, they could lead to more efficient use of resources, in terms of both how firms invest their funds and the use of financial strategies to exploit loopholes.

## **3. THE ESTATE TAX**

Freezing the estate tax at its 2009 levels (a \$3 million exemption and a 45-percent tax rate) would both prevent the scheduled one-year repeal of the tax in 2010 and liberalize the tax relative to its pre-2001 status to which it would revert in 2011. As discussed above with regard to McCain's proposed reduction in the tax, economists are sharply divided on how the estate tax affects economic behavior. Some hold that the tax causes wealthy people to save and invest less than they otherwise would while others maintain that the tax could actually encourage people to save more so their estates would have additional assets to pay the tax. All of the observations made earlier about what McCain would do with the tax apply to Obama's proposal as well, albeit with less force because Obama would cut the tax far less. That smaller reduction would maintain more of the estate tax's function as a backstop to the income tax and would lose significantly less revenue than McCain's larger proposed cut.

## **4. OTHER ISSUES**

The Obama plan includes several provisions that do not provide additional tax benefits, but do affect the tax benefits individuals receive and how they interact with the tax code. An important example is the proposal to mandate automatic enrollment in 401(k) plans and require employers who do not offer them to establish automatic IRAs. These proposals apply the findings of recent

research that shows people are much more likely to contribute to retirement saving plans if they are automatically enrolled, with an option to opt out, than if they have to make an active decision to participate. The Obama approach is being tried in other countries, including the United Kingdom and New Zealand. It promises to be more effective than existing saving incentives, which to a large degree give people tax benefits for saving they would do without the incentive.

The Obama plan also includes a proposal to have the IRS prepare tax returns for most taxpayers based on information reported by employers and financial institutions. This would simplify tax filing for taxpayers who do not itemize deductions, whose only sources of income are earnings, interest, and dividends, and who do not take advantage of the numerous and growing special incentives in the tax code – a declining, but still large number of potential beneficiaries. It would, however, require significant changes in reporting requirements for the Social Security Administration (which does not supply earnings records to IRS until after the tax filing season) and private sector financial institutions to give the IRS the data needed to calculate tax liability and would raise costs of tax administration to IRS. Further, proposals to add new tax credits would reduce the number of taxpayers for which this option could be feasible.

## **5. EFFICIENCY CONSEQUENCES**

Senator Obama's plan would substantially increase the deficit compared with current law and would add nearly \$3.3 trillion to the national debt over ten years. Top marginal income tax rates would increase to their pre-2001 levels, but top capital gains tax rates would be higher and dividend tax rates lower. The effect of the higher capital gains tax is a mixed bag, however. (See Burman, 1999, for a discussion.) Higher tax rates on capital gains encourage investors to hold assets longer than they would otherwise, may deter risk-taking, and contribute to the double-taxation of corporate equity. But reducing the difference between the tax rates on capital gains and other income lessens the incentive to use economically inefficient tax shelters to convert ordinary income into capital gains. The lower tax rate on dividends compared with current law in 2011 reduces double taxation of corporate equity and thus gives firms less artificial incentive to retain earnings instead of paying dividends. Together, the capital gains and dividends provisions probably have little or no effect on the performance of the economy.

Obama's proposals to tax carried interest as ordinary income, limit international corporate tax shelters, improve information reporting, apply the "economic substance doctrine" to business transactions, and reduce the tax gap could all improve economic efficiency by reducing the incentive to engage in purely tax-motivated transactions. Corporations and high-income individuals would be motivated to select investments and arrange compensation to maximize productivity rather than simply to reduce tax liability. But some of the proposals may generate much less revenue than the Obama campaign claims, because the sophisticated tax avoidance techniques that Obama wants to reduce are difficult to control.

Overall, the economic effect of the Obama proposals will depend on how the resulting deficits are closed. If the deficits result in higher tax rates in the future, the economy will be harmed. If they are closed by spending cuts, the economic costs will be lower, but the long-term gain in progressivity may also be diminished depending on which programs are cut.

### C. COMPARISON OF BUDGETARY EFFECTS

Under current law (assuming the tax cuts expire on schedule, the AMT is not patched) the CBO projects that debt held by the public would remain roughly constant over the next ten years, growing from \$5.0 trillion in 2007 to \$5.2 trillion in 2018. Because of the expiration of the Bush tax cuts and the explosive growth of the AMT, tax revenues are projected to increase from 18.8 percent of GDP to 20.3 percent over that time interval while spending is expected to fall from 20 percent of GDP to 19.4 percent, despite significant increases in mandatory spending (for Social

**Table R3**  
**Revenue Effect of Candidates' Tax Plans**  
**Impact on Tax Revenue, 2009-2018**

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total 2009-2018
<b>Change in Tax Revenue Against Current Law (billions of dollars)</b>											
<b>McCain</b>	-42.1	-119.4	-247.7	-373.3	-386.1	-393.6	-449.9	-492.3	-532.2	-573.2	-3,609.7
<b>Obama</b>	-13.8	-83.0	-186.7	-290.1	-310.9	-328.7	-347.3	-368.1	-390.3	-414.1	-2,732.9
<b>Change in Tax Revenue Against Current Policy (billions of dollars)</b>											
<b>McCain</b>	-19.3	-58.3	-35.2	-55.6	-47.7	-34.2	-68.3	-85.8	-98.9	-111.7	-615.0
<b>Obama</b>	8.9	-21.9	25.8	27.7	27.5	30.7	34.3	38.3	43.0	47.4	261.7
<b>Revenues Collected (percent of GDP)</b>											
<b>McCain</b>	18.6	17.9	17.9	17.9	17.8	17.9	17.7	17.7	17.7	17.8	17.9
<b>Obama</b>	18.8	18.2	18.3	18.4	18.2	18.2	18.3	18.3	18.4	18.5	18.4
<b>Baseline Revenues (percent of GDP)</b>											
<b>Current Law</b>	18.9	18.7	19.4	20.0	19.9	20.0	20.0	20.1	20.2	20.3	19.8
<b>Current Policy</b>	18.8	18.3	18.1	18.2	18.0	18.1	18.1	18.1	18.2	18.3	18.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5), various JCT scores, the fiscal year 2009 Treasury blue book, and CBO's most recent budget projections.

For more detailed tables, see  
<http://www.taxpolicycenter.org/numbers/displayatab.cfm?template=simulation&SimID=266>

Security, Medicare, and Medicaid). Discretionary spending (including war spending) and interest on the debt are projected to decline.

Under either Senator Obama's or Senator McCain's plan, however, the debt would likely continue to rise as it has over the past eight years, even under the CBO's relatively optimistic assumptions about spending. Senator Obama's plan would add \$3.3 trillion to the national debt (including additional interest costs) while Senator McCain's plan would add \$4.3 trillion. This does not include the cost of expanding health insurance coverage and assumes that Senator McCain's proposals phase in and phase out on schedule. It also assumes that all of the candidates' optimistic revenue offsets materialize. If any of these assumptions turned out to be unwarranted, the national debt would grow even more.

Another way to look at the candidates' proposals is how much revenues would be as a share of GDP. Under Senator Obama's plan, revenues would total 18.2 percent of GDP in 2013—at the

end of a hypothetical first term. This is about the average revenue collected by the federal government since World War II. Under Senator McCain's plan, the revenue yield would be about 17.8 percent. Given that demands on the federal government are likely to exceed historical levels in 2013 (CBO projects spending at 19.5 percent of GDP, even assuming a wind-down of war-related expenses), these estimates imply that substantial cuts in spending would be required to balance the budget if all of the proposed tax cuts were enacted.

Senator McCain's tax plan uses a variety of phase-ins, apparently to hold down revenue costs. For example, one provision would double the dependent exemption but would do so immediately only for low-income married couples; the increase would take effect only gradually for other taxpayers and not reach full value until 2016. Similarly he would reduce the tax rate on corporations over six years: the tax would not reach its ultimate 25-percent rate until 2015. And he proposes to index the AMT exemption amount at the rate of inflation until 2013, then at that rate plus 5 percentage points until the exemption for couples reaches \$143,000, and thereafter at the rate of inflation again. All of the phase-ins complicate the tax code and mask the true revenue costs of the proposals. And McCain's plan to allow businesses to expense some of their investment in equipment would last only five years—after 2013 firms would have to revert to depreciating such investments. Setting an expiration date for the proposal may encourage businesses to invest more in the short run but any increase would likely just shift investment forward in time and would not represent a long-run expansion of the economy. These features of McCain's tax plan all constitute budget gimmicks that have no value other than to shift the timing of economic activity and alter the pattern of revenue losses over time. If all provisions in the tax plan were phased in immediately and made permanent, the ten-year reduction in federal revenue would jump 11 percent—or \$400 billion—from \$3.6 trillion to \$4.0 trillion.

## IV. DISTRIBUTIONAL EFFECTS

The distributional effects of both the Obama and the McCain tax plans would vary over time, both because their individual proposals would phase in rather than taking effect immediately and because they interact with the Bush tax cuts that are scheduled to expire in 2011. Our analysis therefore shows the distribution of tax changes both before and after that expiration—in 2009 and in 2012—and, for 2012, compared separately against baselines that do and do not assume extension of current law beyond 2010.

### A. THE OBAMA PLAN

**Effects in 2009.** In 2009, Senator Obama's tax plan would, on average, provide a modest tax cut equal to 0.3 percent of after-tax income, or \$160 (table 1). But his plan would drastically alter the distribution of tax burdens and make the tax system significantly more progressive. Households in the bottom quintile of the cash income distribution (the 20 percent of the population with the lowest incomes) would receive an average tax cut of 5.5 percent of income (\$567) and those in the middle fifth of the income distribution would receive an average cut equal to 2.4 percent of income (\$1,042). In contrast, taxes would rise by an average of 2.0 percent of income (\$4,092) for households in the top quintile. And the increases would be even more dramatic within the top quintile. Taxpayers in the top 1 percent would see their taxes rise by an average of 8.7 percent of

income or about \$116,000. The top 0.1 percent—the richest 1 in 1,000—would face an average tax increase of more than \$700,000, or 11.5 percent of income.

**Table 1**  
**Senator Barack Obama's Tax Proposals**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2009**

Cash Income Percentile <sup>1,2</sup>	Percent of Tax Units <sup>3</sup>		Percent Change in After-Tax Income <sup>4</sup>	Average Federal Tax Change (\$)	Average Federal Tax Rate <sup>5</sup>	
	With Tax Cut	With Tax Increase			Change (%)	Under the Proposal
<b>Lowest Quintile</b>	67.8	7.7	5.5	-567	-5.3	-0.7
<b>Second Quintile</b>	86.1	8.4	3.6	-892	-3.2	7.5
<b>Middle Quintile</b>	91.6	7.1	2.4	-1,042	-2.0	14.9
<b>Fourth Quintile</b>	86.2	12.3	1.8	-1,290	-1.5	18.5
<b>Top Quintile</b>	76.1	23.1	-2.0	4,092	1.5	27.8
<b>All</b>	80.8	10.9	0.3	-160	-0.2	21.6
<b>Addendum</b>						
<b>80-90</b>	83.0	15.5	2.1	-2,204	-1.6	21.2
<b>90-95</b>	84.8	15.0	1.9	-2,789	-1.5	23.1
<b>95-99</b>	65.3	34.4	0.0	12	0.0	26.5
<b>Top 1 Percent</b>	7.0	92.9	-8.7	115,974	6.1	35.7
<b>Top 0.1 Percent</b>	1.0	99.0	-11.5	701,885	7.9	39.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).  
Calendar year.

(1) Tax units with negative cash income are excluded from the lowest income class but are included in the totals. For a description of cash income, see

<http://www.taxpolicycenter.org/TaxModel/income.cfm>

(2) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$18,981, 40% \$37,595, 60% \$66,354, 80% \$111,645, 90% \$160,972, 95% \$226,918, 99% \$603,402, 99.9% \$2,871,682.

(3) Includes both filing and non-filing units but excludes those that are dependents of other tax units.

(4) After-tax income is cash income less: individual income tax net of refundable credits; corporate income tax; payroll taxes (Social Security and Medicare); and estate tax.

(5) Average federal tax (includes individual and corporate income tax, payroll taxes for Social Security and Medicare, and the estate tax) as a percentage of average cash income.

Households in the lower quintiles benefit from a number of provisions in the Obama plan. Obama would create several new refundable credits (i.e., credits available regardless of income tax liability), including ones for mortgage interest and education expenses, and would expand and make fully refundable both the child and dependent care credit and the saver's credit. Households in the bottom quintiles would also benefit from Senator Obama's expansion of the Earned Income Tax Credit (EITC). In addition, the Making Work Pay credit would provide up to \$500 (\$1,000 for couples) for lower- and moderate-income working households regardless of income tax liability.

Taxpayers at the very top of the income distribution would be hit hard by the increase in the top two tax rates from 33 and 35 percent to 36 and 39.6 percent as well as the increase in the top tax rate on capital gains and qualified dividends to 25 percent. Upper-income households would also be hurt by Senator Obama's reinstatement of the limitations on personal exemptions and itemized deductions, which had been phased out by the Economic Growth and Tax Relief

Reconciliation Act of 2001 (EGTRRA). In addition, upper-income households ultimately bear the burden of the corporate tax increases that Senator Obama proposes. The TPC follows the Congressional Budget Office (CBO) by assuming that the corporate income tax is fully borne by all capital. Thus we distribute corporate tax changes to individual households based on their share of capital income (interest, dividends, capital gains, and rents). Since the distribution of capital income is highly concentrated at the top of the income scale, the corporate tax is highly progressive.<sup>9</sup> As a result, Senator Obama's corporate tax increases are borne primarily by households in the top quintile. Finally, even though taxpayers in the 80<sup>th</sup> through 95<sup>th</sup> percentiles would be hurt by the individual income tax rate increases and the corporate tax hikes, they would also benefit from Senator Obama's extension of the AMT "patch". As a result, on average, taxpayers in that income range would receive average tax cuts of about 2 percent of income.

Overall, about 81 percent of households would owe less tax whereas only about 11 percent would be hit by a tax increase. Again, outcomes would differ significantly by income. Only 7 percent of households in the middle of the income spectrum would face a tax increase. In contrast, 23 percent of those in the top quintile would pay higher taxes. Within the top quintile, more than 90 percent of those in the top 1 percent would pay more, including virtually all households in the top 0.1 percent.

**Effects in 2012.** Under current law, virtually all of the provisions of the 2001–06 tax cuts will expire at the end of 2010.<sup>10</sup> Senator Obama's plan would extend most of the provisions affecting lower- and middle-income households and create the new refundable credits discussed above. Thus, measured against current law, the Obama plan would provide much larger tax cuts for lower- and moderate-income households in 2012 than in 2009. Households in the bottom quintile would see an average tax cut of 6.2 percent of after-tax income or \$698 (table 2). Households in the middle of the income distribution would receive an average tax cut equal to 4.6 percent of income or \$2,136.

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<sup>9</sup> For more details, including information on the current-law distribution of the corporate income tax and other federal taxes, see Rohaly (2008).

<sup>10</sup> Provisions relating to select retirement savings incentives were made permanent by the Pension Protection Act of 2006 (P.L. 109-280).

**Table 2**  
**Senator Barack Obama's Tax Proposals**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2012**

Cash Income Percentile <sup>1</sup>	Percent of Tax Units		Percent Change in After-Tax Income	Average Federal Tax Change (\$)	Average Federal Tax Rate	
	With Tax Cut	With Tax Increase			Change (% Points)	Under the Proposal
<b>Lowest Quintile</b>	68.2	7.5	6.2	-698	-5.8	-0.4
<b>Second Quintile</b>	87.9	6.6	5.9	-1,591	-5.1	8.0
<b>Middle Quintile</b>	95.8	3.4	4.6	-2,136	-3.7	15.6
<b>Fourth Quintile</b>	97.2	2.6	4.4	-3,370	-3.4	18.9
<b>Top Quintile</b>	93.3	6.7	1.5	-3,286	-1.1	27.6
<b>All</b>	86.6	5.6	3.2	-2,013	-2.4	21.6
<b>Addendum</b>						
<b>80-90</b>	97.0	3.0	4.4	-4,985	-3.3	21.8
<b>90-95</b>	96.8	3.2	3.8	-5,969	-2.8	23.4
<b>95-99</b>	88.1	11.9	2.3	-6,213	-1.7	26.5
<b>Top 1 Percent</b>	59.2	40.7	-2.9	38,389	1.9	35.1
<b>Top 0.1 Percent</b>	29.5	70.5	-5.1	301,401	3.3	39.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to table 1.

(1) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$19,740, 40% \$38,980, 60% \$69,490, 80% \$117,535, 90% \$169,480, 95% \$237,040, 99% \$619,561, 99.9% \$2,832,449.

Since some of Obama's proposals affecting upper-income households, such as the individual income tax rate increases to 36 and 39.6 percent, are already scheduled to occur after 2010 under current law, his plan appears to raise taxes less on upper-income households in 2012 than in 2009 when measured against a current-law baseline. In fact, in 2012, the Obama plan would provide an average tax cut to the top quintile of 1.5 percent of income or \$3,286. Only about two-fifths of taxpayers in the top 1 percent of the population would face a tax hike. For them, the increase in the tax rates on capital gains and dividends, as well as the corporate and estate tax increases outweigh the other elements of Obama's plan. Overall, less than 6 percent of all households would experience a tax increase in 2012 compared to current law. Almost 9 in 10 households would receive a tax cut, including almost 60 percent of those in the top 1 percent of the income distribution.

Measuring Obama's plan against an alternative baseline in which the 2001-06 tax cuts are made permanent and the 2007 AMT patch is extended and indexed for inflation markedly alters its assessed effects. Those at the top of the income scale would face much larger tax increases and taxpayers lower in the income distribution would gain less (table 3). Measured against this alternative baseline, middle-income households would receive an average tax cut of 2.0 percent of income or \$969. Those in the top fifth of the income distribution would face an average tax increase of 3.4 percent of income, or \$7,748. The top 1 percent would be hit by an average tax hike of more than 9 percent of income or \$133,715.

**Table 3**  
**Senator Barack Obama's Tax Proposals**  
**Against a Tax Cuts Extended, AMT Patched Baseline**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2012**

Cash Income Percentile <sup>1</sup>	Percent of Tax Units		Percent Change in After-Tax Income	Average Federal Tax Change (\$)	Average Federal Tax Rate	
	With Tax Cut	With Tax Increase			Change (%) Points)	Under the Proposal
<b>Lowest Quintile</b>	67.8	7.7	5.4	-617	-5.2	-0.4
<b>Second Quintile</b>	85.7	8.4	3.4	-950	-3.1	8.0
<b>Middle Quintile</b>	90.2	8.2	2.0	-969	-1.7	15.6
<b>Fourth Quintile</b>	81.7	15.3	1.0	-753	-0.8	18.9
<b>Top Quintile</b>	52.3	43.6	-3.4	7,748	2.5	27.6
<b>All</b>	76.2	14.6	-0.7	458	0.6	21.6
<b>Addendum</b>						
<b>80-90</b>	74.5	22.7	0.4	-432	-0.3	21.8
<b>90-95</b>	44.5	49.1	-0.3	486	0.2	23.4
<b>95-99</b>	17.5	76.8	-2.0	5,601	1.5	26.5
<b>Top 1 Percent</b>	4.6	95.1	-9.4	133,715	6.7	35.1
<b>Top 0.1 Percent</b>	0.5	99.5	-12.4	789,241	8.6	39.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to table 1.

(1) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$19,740, 40% \$38,980, 60% \$69,490, 80% \$117,535, 90% \$169,480, 95% \$237,040, 99% \$619,561, 99.9% \$2,832,449.

**Impact on various demographic groups.** The impact of Senator Obama's tax proposal differs across filing statuses. Overall, heads of household would receive the largest average tax cut in 2009: 2.8 percent of income (table 4).<sup>11</sup> As a percent of after-tax income, married couples filing jointly would fare the worst, facing a tax increase of 0.1 percent of income. Single filers would receive a tax cut equal to 0.5 percent of income. The impacts differ across filing status for two reasons: (1) the Obama plan contains tax breaks that are targeted to certain segments of the population; and (2) different demographic groups contain varying income profiles that cause them to be affected differently by Obama's highly progressive tax plan.

Heads of household benefit the most because, on average, they have the lowest incomes (\$40,351 in 2009) and because they would tend to benefit from the EITC expansion, the refundability of the child and dependent care credit, and the Making Work Pay credit. In contrast, married couples have much higher average incomes (\$125,155 in 2009) and so, overall, tend to be hit more by the provisions that raise taxes on upper-income earners such as the higher statutory tax rates, as well as the increases in the rates on capital gains and dividends.

Effects of the tax proposals differ less across filing status within income quintiles. Taxpayers in the middle of the income distribution, for example, would receive about the same average benefit regardless of filing status, about 3 percent of income. Similarly, taxpayers in the top 1 percent

<sup>11</sup> In the estimates for demographic groups in table 4, we use CBO's methodology and adjust the income classifier for family size by dividing cash income by the square root of the number of members of the tax unit. For a more detailed explanation and an examination of the impact of adjusting for family size on the distribution of tax burdens, see Rohaly (2008).



would see an average tax increase of about 8.5 percent of income, again regardless of their filing status. The different overall effects by filing status result primarily from the unequal distribution by filing status across income categories.

**Table 4**  
**Senator Barack Obama's Tax Proposals**  
**Percentage Change in After-Tax Income For Various Demographic Groups**  
**By Cash Income Adjusted for Family Size, 2009**

Cash Income Percentile <sup>1</sup>	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children <sup>2</sup>	Elderly <sup>3</sup>
Lowest Quintile	6.3	6.3	5.8	6.9	7.2	0.9
Second Quintile	3.9	3.5	4.0	4.2	4.7	0.8
Middle Quintile	2.8	2.8	2.8	2.8	3.1	1.3
Fourth Quintile	2.3	1.7	2.6	2.2	3.3	0.9
Top Quintile	-2.0	-2.3	-1.8	-1.1	-1.4	-3.8
All	0.3	0.5	-0.1	2.8	1.2	-1.9
<b>Addendum</b>						
80-90	1.9	0.5	2.4	1.5	3.2	0.0
90-95	1.5	-0.3	2.0	1.4	2.8	-0.5
95-99	0.0	-0.9	0.3	-0.5	-0.1	-1.1
Top 1 Percent	-8.5	-8.5	-8.4	-8.3	-8.8	-9.3
Top 0.1 Percent	-11.4	-12.1	-11.2	-11.3	-11.4	-12.0

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to Table 1.

- (1) Quintiles are defined for the population as a whole, not the various subgroups.
- (2) Children are defined as exemptions taken for children living at, or away from, home.
- (3) Elderly tax units are those in which the head (or spouse, if applicable) is age 65 or older.

Households with children fare better than the population as a whole: they receive an average increase in after-tax income of 1.2 percent, double the figure for all households. This general result holds within quintiles as well. Those with children receive larger average tax cuts (or smaller average tax increases) within all five quintiles. At the bottom of the income scale, this is due largely to the EITC expansion and the refundability of the child and dependent care credit. At higher income levels, the extension of the AMT patch tends to benefit those with children since the AMT disallows dependent exemptions.

Even though Senator Obama's plan eliminates individual income taxes for seniors with incomes less than \$50,000, his plan would raise taxes for almost 10 million senior households, over a third of the total (not shown in table). On average, seniors would face a tax increase of about 2 percent of income. The impact varies by quintile, however: seniors in the bottom two quintiles of the income distribution would see an average tax cut of almost 1.0 percent of income, while those in the top quintile would experience an average tax increase equal to 3.8 percent of income. Taxes would increase by an average 9.3 percent of income for the 390,000 seniors in the top 1 percent.

Retirees would generally benefit from few of Obama's new tax credit proposals such as the Making Work Pay credit and the American Opportunity tax credit for education or from his expansions to the EITC or the child and dependent care credit. Instead, increases in the tax rates on capital gains and dividends would typically hurt them. In addition, because more of their income comes from capital, higher-income seniors would bear much of the burden of Obama's corporate tax increases.

**Table 5**  
**Senator Barack Obama's Tax Proposals**  
**Percentage Change in After-Tax Income For Various Demographic Groups**  
**By Cash Income Adjusted for Family Size, 2012**

Cash Income Percentile <sup>1</sup>	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children <sup>2</sup>	Elderly <sup>3</sup>
<b>Lowest Quintile</b>	7.5	6.6	8.2	8.2	9.6	1.1
<b>Second Quintile</b>	6.4	4.7	7.0	7.6	9.0	1.7
<b>Middle Quintile</b>	5.1	4.4	5.4	5.3	6.3	2.9
<b>Fourth Quintile</b>	4.3	3.4	4.8	3.8	5.6	2.9
<b>Top Quintile</b>	1.5	2.2	1.4	1.4	1.6	1.1
<b>All</b>	3.2	3.4	2.9	5.3	4.2	1.7
<b>Addendum</b>						
<b>80-90</b>	4.0	3.5	4.2	2.9	4.4	3.6
<b>90-95</b>	3.6	3.4	3.7	2.7	3.9	3.7
<b>95-99</b>	2.5	3.7	2.3	1.6	2.0	3.2
<b>Top 1 Percent</b>	-2.7	-2.3	-2.7	-2.9	-2.7	-3.2
<b>Top 0.1 Percent</b>	-5.0	-5.9	-4.8	-5.3	-5.0	-5.7

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to Table 1.

- (1) Quintiles are defined for the population as a whole, not the various subgroups.
- (2) Children are defined as exemptions taken for children living at, or away from, home.
- (3) Elderly tax units are those in which the head (or spouse, if applicable) is age 65 or older.

The general pattern across demographic groups is much the same in 2012 as in 2009, although the average tax cuts are much larger since they include Obama's partial extension of the 2001–06 tax reductions (table 5). Overall, singles, heads of household, and tax units with children would all fare better than the population as a whole. Married couples and the elderly, on average, would do worse. Again, however, much of that differential results from variation in average incomes across demographic groups. Among households in the middle of the income distribution, those with children receive the largest average benefit, 6.3 percent of income. Middle-income married couples and heads of household receive average benefits of 5.4 and 5.3 percent respectively, better than the average for all middle-income households, which is 5.1 percent. Middle-income elderly fare the worst, receiving an average increase in after-tax income of only 2.9 percent.

## ***B. THE MCCAIN PLAN***

**Effects in 2009.** Unlike Senator Obama's tax proposals, Senator McCain's plan includes several provisions—including the increase in the dependent exemption and the reduction in the corporate tax rate to 25 percent—that would phase in gradually over time. Thus, in order to analyze the impact of McCain's plan, we examine the distribution of all provisions in their fully-phased-in form, evaluated at 2009 (and below, at 2012) income levels.

In 2009, the fully-phased-in McCain tax plan would, on average, provide a tax cut equal to 2.0 percent of after-tax income, or \$1,195 (table 6). The distribution of benefits from his plan would be regressive. Households in the bottom quintile of the cash income distribution would receive an average tax cut of just 0.2 percent of income (\$19) and those in the middle fifth of the income distribution would receive an average cut equal to 0.7 percent of income (\$319). Households in the top quintile, however, would get an average tax cut of 3.0 percent of income (\$6,264). Within the top quintile, the decreases would be significantly larger. Taxpayers in the top 1 percent of the population would see their taxes fall by an average of 3.4 percent of income or more than \$40,000 and the richest 1 in 1,000 would see an average tax cut of almost \$270,000 or 4.4 percent of income.

Those at the top of the income scale benefit from a number of provisions in the McCain tax plan in 2009. Senator McCain would raise the estate tax exemption from \$3.5 million to \$5 million and would drastically cut the rate on estates above that amount to 15 percent from 45 percent. In addition, the benefits of the cuts in the corporate income tax would accrue largely to those at the top of the income distribution because of the progressive nature of the distribution of capital income. In addition, the extension of the AMT patch would benefit households in the 80th to 95th percentile, reducing the amount of AMT that they would owe or sparing them from the tax altogether. In contrast, more moderate- and lower-income households would tend to benefit only from the increased dependent exemption. And that increase would not benefit households that do not owe individual income tax under current law. Thus, while Senator McCain's plan provides a tax cut to nearly 60 percent of all households, fewer than one in five households in the bottom quintile and less than half those in the second quintile would see their taxes go down.

**Table 6**  
**Senator John McCain's Tax Proposals, Fully Phased In**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2009**

Cash Income Percentile <sup>1</sup>	Percent of Tax Units		Percent Change in After-Tax Income	Average Federal Tax Change (\$)	Average Federal Tax Rate	
	With Tax Cut	With Tax Increase			Change (% Points)	Under the Proposal
<b>Lowest Quintile</b>	17.3	0.0	0.2	-19	-0.2	4.4
<b>Second Quintile</b>	44.2	0.1	0.5	-113	-0.4	10.3
<b>Middle Quintile</b>	65.6	0.1	0.7	-319	-0.6	16.3
<b>Fourth Quintile</b>	84.2	0.1	1.4	-1,009	-1.2	18.8
<b>Top Quintile</b>	96.9	0.1	3.0	-6,264	-2.2	24.1
<b>All</b>	56.0	0.1	2.0	-1,195	-1.6	20.2
<b>Addendum</b>						
<b>80-90</b>	95.4	0.1	2.5	-2,614	-1.9	20.9
<b>90-95</b>	98.5	0.1	3.0	-4,380	-2.3	22.2
<b>95-99</b>	98.5	0.2	3.1	-7,871	-2.3	24.2
<b>Top 1 Percent</b>	98.0	0.1	3.4	-45,361	-2.4	27.2
<b>Top 0.1 Percent</b>	99.6	0.0	4.4	-269,364	-3.0	28.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to table 1.

(1) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$18,981, 40% \$37,595, 60% \$66,354, 80% \$111,645, 90% \$160,972, 95% \$226,918, 99% \$603,402, 99.9% \$2,871,682.

**Effects in 2012.** As noted above, the 2001–06 tax cuts expire at the end of 2010. Senator McCain’s plan would make permanent all of those tax cuts except for full repeal of the estate tax. But the plan’s proposed 15-percent estate tax rate and \$5 million exemption would cut estate tax liability to less than \$10 billion a year through the end of the budget window.

McCain’s overall tax plan would grow more regressive between 2009 and 2012.<sup>12</sup> Measured against current law, the fully-phased-in McCain plan would cut 2012 taxes for those in the bottom quintile by 0.9 percent of income, or about \$100 (table 7). Households in the middle of the income distribution would receive an average tax cut of 3.1 percent of income, or \$1,444. The top fifth would receive an increase in after-tax income of 6.4 percent or \$13,858. And the largest cuts would go to those at the very top of the income distribution: the top 1 percent would receive cuts averaging 9.5 percent of income (\$126,951) while the richest 1 in 1,000 would see their after-tax incomes rise by 11.6 percent, or about \$680,000, more than ten times the relative gain of those in the bottom quintile.

<sup>12</sup> For estimates of the distribution of the 2001–06 tax cuts, see Leiserson and Rohaly (2006), Rohaly (forthcoming) and the TPC website at <http://www.taxpolicycenter.org/taxtopics/cuts0106.cfm>.

**Table 7**  
**Senator John McCain's Tax Proposals, Fully Phased In**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2012**

Cash Income Percentile <sup>1</sup>	Percent of Tax Units		Percent Change in After-Tax Income	Average Federal Tax Change (\$)	Average Federal Tax Rate	
	With Tax Cut	With Tax Increase			Change (% Points)	Under the Proposal
<b>Lowest Quintile</b>	38.6	1.8	0.9	-101	-0.8	4.5
<b>Second Quintile</b>	89.0	1.1	2.8	-764	-2.5	10.6
<b>Middle Quintile</b>	98.1	0.2	3.1	-1,444	-2.5	16.8
<b>Fourth Quintile</b>	99.6	0.1	4.1	-3,126	-3.2	19.1
<b>Top Quintile</b>	99.9	0.1	6.4	-13,858	-4.5	24.1
<b>All</b>	81.0	0.8	4.9	-3,065	-3.7	20.4
<b>Addendum</b>						
<b>80-90</b>	99.9	0.1	4.8	-5,449	-3.6	21.5
<b>90-95</b>	100.0	0.1	4.8	-7,581	-3.5	22.6
<b>95-99</b>	99.9	0.0	5.3	-14,340	-3.8	24.4
<b>Top 1 Percent</b>	99.9	0.1	9.5	-126,951	-6.4	26.8
<b>Top 0.1 Percent</b>	100.0	0.0	11.6	-678,490	-7.4	28.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to table 1.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$19,740, 40% \$38,980, 60% \$69,490, 80% \$117,535, 90% \$169,480, 95% \$237,040, 99% \$619,561, 99.9% \$2,832,449.

Under Senator McCain's plan, the highest-income households would benefit most from extending the 2001–06 individual income tax cuts, including the reduction in the top marginal rate from 39.6 percent to 35 percent, the reduction in the rate on capital gains and qualified dividends to no more than 15 percent, and the repeal of the limitation on itemized deductions and personal exemptions. In addition, they are the primary beneficiaries of the corporate rate cuts proposed by McCain. And, except for those at the very top, wealthier households benefit from the extension of the AMT patch proposed by the Senator.<sup>13</sup>

<sup>13</sup> Since the top rate in the regular income tax of 35 percent exceeds the top statutory rate of 28 percent in the AMT, very high income households that do not engage in substantial sheltering generally wind up in the regular tax system. See Leiserson and Rohaly (forthcoming) for details.

**Table 8**  
**Senator John McCain's Tax Proposals, Fully Phased In**  
**Against a Tax Cuts Extended, AMT Patched Baseline**  
**Distribution of Federal Tax Change by Cash Income Percentile, 2012**

Cash Income Percentile <sup>1</sup>	Percent of Tax Units		Percent Change in After-Tax Income	Average Federal Tax Change (\$)	Average Federal Tax Rate	
	With Tax Cut	With Tax Increase			Change (% Points)	Under the Proposal
<b>Lowest Quintile</b>	17.8	0.0	0.2	-20	-0.2	4.5
<b>Second Quintile</b>	45.3	0.2	0.5	-123	-0.4	10.6
<b>Middle Quintile</b>	63.5	0.1	0.6	-282	-0.5	16.8
<b>Fourth Quintile</b>	78.6	0.0	0.7	-512	-0.5	19.1
<b>Top Quintile</b>	87.4	0.2	1.2	-2,826	-0.9	24.1
<b>All</b>	53.7	0.1	0.9	-596	-0.7	20.4
<b>Addendum</b>						
<b>80-90</b>	86.5	0.2	0.8	-899	-0.6	21.5
<b>90-95</b>	88.4	0.2	0.7	-1,127	-0.5	22.6
<b>95-99</b>	86.5	0.1	0.9	-2,528	-0.7	24.4
<b>Top 1 Percent</b>	96.1	0.2	2.2	-31,628	-1.6	26.8
<b>Top 0.1 Percent</b>	99.1	0.4	3.0	-190,653	-2.1	28.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to table 1.

(3) The cash income percentile classes used in this table are based on the income distribution for the entire population and contain an equal number of people, not tax units. The breaks are (in 2008 dollars): 20% \$19,740, 40% \$38,980, 60% \$69,490, 80% \$117,535, 90% \$169,480, 95% \$237,040, 99% \$619,561, 99.9% \$2,832,449.

Measuring McCain's plan against an alternative baseline in which the 2001–06 tax cuts are made permanent and the 2007 AMT patch is extended and indexed for inflation makes the tax reductions much more modest although still regressive. Overall, households would receive an average tax cut representing 0.9 percent of income or \$596 (table 8). Households in the bottom quintile would receive an average increase in after-tax income of just 0.2 percent. Largely because of the increase in the dependent exemption, those in the middle would see their after-tax incomes rise by an average of 0.6 percent. The increase in the dependent exemption and the corporate tax cuts would benefit those at the top: those in the highest quintile would get an average cut of 1.2 percent of income.

**Impact on various demographic groups.** The impact of Senator McCain's tax proposal differs across filing statuses but less so than the proposal from Senator Obama. Overall, married couples filing jointly would receive the largest average tax cut in 2009 under the McCain plan: 2.3 percent of income (table 9). In contrast, heads of household would, on average, see their after-tax income rise 1.4 percent and single filers would receive a tax cut equal to 2.9 percent of income.

**Table 9**  
**Senator John McCain's Tax Proposals, Fully Phased In**  
**Percentage Change in After-Tax Income For Various Demographic Groups**  
**By Cash Income Adjusted for Family Size, 2009**

Cash Income Percentile <sup>1</sup>	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children <sup>2</sup>	Elderly <sup>3</sup>
Lowest Quintile	0.2	0.2	0.2	0.0	0.1	0.3
Second Quintile	0.6	0.3	0.7	1.0	1.0	0.5
Middle Quintile	1.0	0.3	1.2	1.5	1.7	0.7
Fourth Quintile	1.6	0.4	2.0	2.0	2.9	0.9
Top Quintile	2.7	2.9	2.7	2.4	2.9	4.1
All	2.0	1.5	2.3	1.4	2.5	2.8
<b>Addendum</b>						
80-90	2.0	0.7	2.4	2.1	3.4	1.8
90-95	2.3	1.1	2.6	2.2	3.5	2.4
95-99	2.8	2.8	2.8	2.3	2.4	4.1
Top 1 Percent	3.5	7.1	2.8	3.1	2.5	6.2
Top 0.1 Percent	4.5	8.9	3.7	4.1	3.5	7.3

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to Table 1.

- (1) Quintiles are defined for the population as a whole, not the various subgroups.
- (2) Children are defined as exemptions taken for children living at, or away from, home.
- (3) Elderly tax units are those in which the head (or spouse, if applicable) is age 65 or older.

Married couples receive the largest average tax cut because they are most likely to be in the top income categories that benefit most from the McCain tax plan. In contrast, heads of household typically are in lower income categories that benefit little from the plan. Heads of household in the lower quintiles do, however, benefit from the increase in the dependent exemption. Single taxpayers do not receive that benefit, however, and thus those in the bottom four quintiles receive much smaller than average increases in their after-tax income.

The increase in the dependent exemption would lead to above-average tax cuts for households with children. And, unlike the Obama plan, the McCain plan would, on average, cut taxes for the elderly: their after-tax incomes would rise by an average of 2.8 percent. That situation results primarily from McCain's proposed cuts in corporate taxes.

Like the Obama plan, the McCain plan would have similar distributional effects across demographic groups in 2012 as in 2009 (table 10).

**Table 10**  
**Senator John McCain's Tax Proposals, Fully Phased In**  
**Percentage Change in After-Tax Income For Various Demographic Groups**  
**By Cash Income Adjusted for Family Size, 2012**

Cash Income Percentile <sup>1</sup>	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children <sup>2</sup>	Elderly <sup>3</sup>
Lowest Quintile	1.4	0.5	2.6	1.5	2.5	0.5
Second Quintile	3.3	1.6	3.9	4.6	5.5	1.2
Middle Quintile	3.4	1.9	4.0	4.2	5.0	2.1
Fourth Quintile	3.7	2.4	4.3	3.8	5.4	3.4
Top Quintile	6.0	7.4	5.7	4.6	5.7	9.0
All	4.9	4.3	5.2	3.9	5.4	6.3
<b>Addendum</b>						
80-90	4.1	3.7	4.2	3.3	4.6	5.4
90-95	4.4	4.8	4.3	3.5	4.5	6.4
95-99	5.2	7.6	4.6	3.9	4.3	8.5
Top 1 Percent	9.6	14.3	8.7	8.7	8.9	12.8
Top 0.1 Percent	11.6	17.1	10.6	10.9	10.5	14.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-5).

See notes to Table 1.

- (1) Quintiles are defined for the population as a whole, not the various subgroups.
- (2) Children are defined as exemptions taken for children living at, or away from, home.
- (3) Elderly tax units are those in which the head (or spouse, if applicable) is age 65 or older.

Married couples filing jointly fare better overall: they receive an average increase in after-tax income of 5.2 percent compared to 4.3 percent for singles and 3.9 percent for head of household tax units. For households in the middle of the income distribution, the average increase in after-tax income ranges from 1.9 percent for singles to 4.2 percent for heads of household. Households with children again do better than the population as a whole, due to several of the provisions in the 2001–06 tax cuts that are made permanent by the McCain plan (the doubling of the child credit amount and its partial refundability, expansion of the child and dependent care credit, marriage penalty relief and so on). And once again, the elderly receive an average increase in after-tax income of 6.3 percent, significantly higher than the 4.9 percent received by the population as a whole.

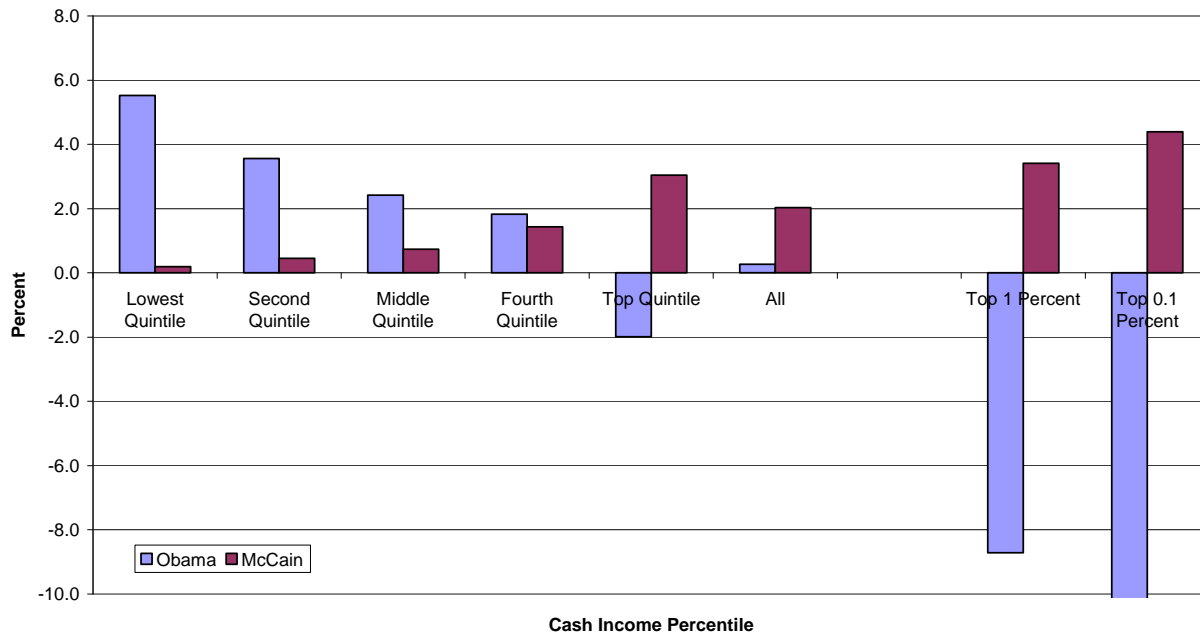
### ***C. COMPARISON OF THE TWO PLANS***

If enacted, the Obama and McCain tax plans would have radically different effects on the distribution of tax burdens in the United States. The Obama tax plan would make the tax system significantly more progressive by providing large tax breaks to those at the bottom of the income scale and raising taxes significantly on upper-income earners. The McCain tax plan would make the tax system more regressive, even compared with a system in which the 2001–06 tax cuts are made permanent. It would do so by providing relatively little tax relief to those at the bottom of



the income scale while providing huge tax cuts to households at the very top of the income distribution.

**Figure 1.**  
**Obama and McCain Tax Proposals**  
**Average Percentage Change in After-Tax Income, 2009**

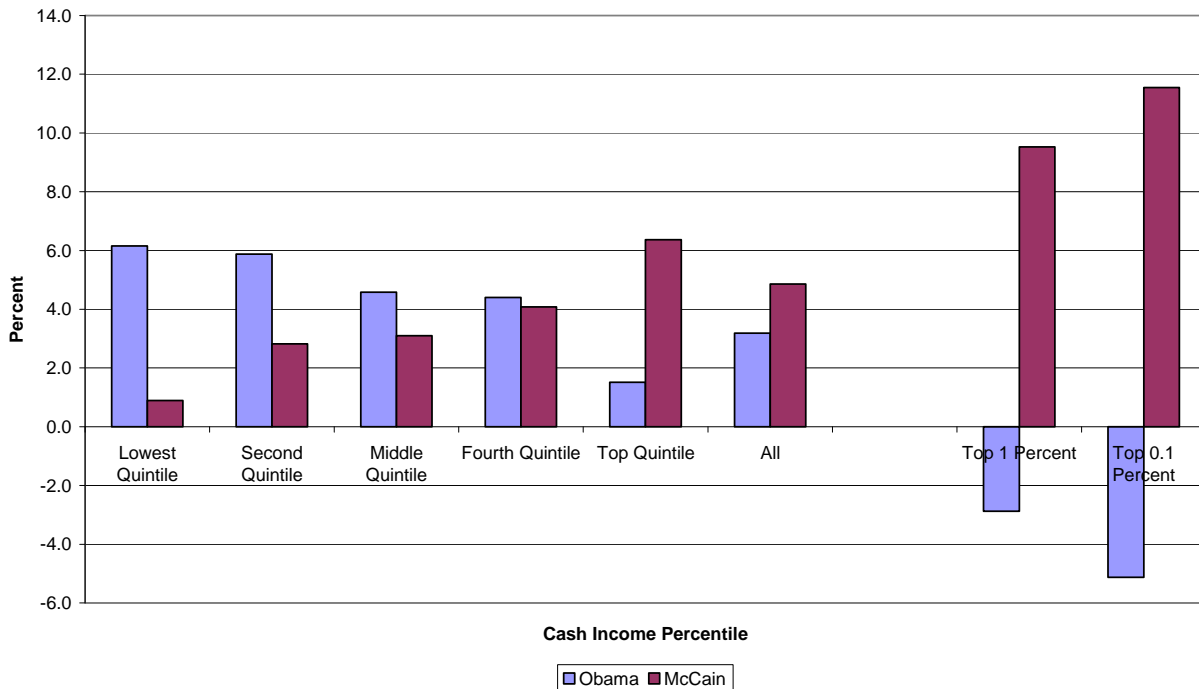


Measured against current law in 2009, Senator Obama’s plan raises after-tax incomes by more than 5.5 percent for those in the bottom quintile and also provides more modest increases for those in the next three quintiles (figure 1). The top quintile would experience an average tax increase because of the hikes in the tax rates on capital gains and dividends and the increases in the top two individual income tax rates. The increase in taxes would be dramatic for those at the very top of the income scale, representing 8.7 percent of after-tax income for the top 1 percent of households and 11.5 percent of income for the richest 1 in 1,000.

In contrast, the McCain plan would provide virtually no benefit to households in the bottom quintile, and very modest benefits to those in the next three quintiles. The top quintile would receive a tax cut of more than 3 percent of after-tax income. Within the top quintile, the richest 1 percent of households would receive an average tax cut of 3.4 percent. That figure rises to almost 4.4 percent for the top 0.1 percent of the income distribution.

The difference in the distributional effects of the two plans is just as stark when measured against current law in 2012 (figure 2).

**Figure 2.**  
**Obama and McCain Tax Proposals**  
**Average Percentage Change in After-Tax Income, 2012**



The Obama plan would still provide the largest tax breaks, measured as a percentage of after-tax income, to those in the bottom quintile. Each quintile would, on average, receive a tax cut but those at the very top of the income scale would receive tax increases. On average, the top 1 percent would receive a tax increase equal to about 3 percent of income; that figure would rise to about 5 percent of income for the richest 1 in 1,000 households.

As in 2009, the McCain tax plan provides very little benefit to households at the bottom of the income distribution in 2012. Households in the lowest quintile receive tax cuts averaging about 1 percent of income. Because McCain’s plan extends all of the regressive 2001–06 tax measures (other than complete repeal of the estate tax) and cuts corporate taxes, those in the top 1 percent receive average cuts representing 9.5 percent of income; that figure is 11.6 percent for the top 0.1 percent of households.

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