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An Updated Analysis of the 2008 Presidential Candidates' Tax Plans: Revised August 15, 2008

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The current revision (8/15/08) reflects modifications to Senator Obama's tax proposals announced on August 14, 2008. See http://origin.barackobama.com/taxes/. This version (9/12/08) incorporates updated budget projections from the Congressional Budget Office (http://www.cbo.gov/ftpdocs/97xx/doc9706/09-08-Update.pdf), corrects some typos, and includes editorial changes. However, we have not yet revised our revenue estimates to take account of CBO's latest economic projections.

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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. In the past year, the federal budget deficit has ballooned, and, more worrisome, 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, at least in part 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 investments in certain capital equipment. Senator Obama would permanently extend certain provisions of the 2001 and 2003 tax cuts primarily affecting taxpayers with incomes under $250,000[1] but repeal the cuts in the top two marginal income tax rates ahead of their scheduled expiration in 2010; increase the maximum rate on capital gains; raise the top tax rate on qualified dividends from its current level (but keep it below pre-2001 levels); and enact new and expanded targeted tax breaks for workers, retirees, homeowners, savers, students, and new farmers. Senator McCain proposes to extend permanently and increase the AMT "patch" that has prevented most individuals and families with incomes below $200,000 from being affected by the tax and lowered the tax for others, 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 an estimated $4.2 trillion (McCain) and $2.9 trillion (Obama) over the next 10 years. 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 $600 billion and Senator McCain's proposals lose a similar amount.

The two candidates' tax plans would have sharply different distributional effects. Senator McCain's tax cuts would primarily benefit those with very high incomes, almost all of whom

[1] Many of Senator Obama's proposals would affect only married couples filing joint tax returns with income above $250,000 and other taxpayers with income above $200,000. For simplicity of exposition, we will often refer to tax provisions affecting only taxpayers with income above $250,000 without saying that the income threshold is $200,000 for taxpayers not filing joint returns. Unless otherwise stated, the two different thresholds apply.

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 tax cuts would be small as a share of after-tax income. 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 significantly.

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 might completely negate 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—homeownership—which could probably be better directed elsewhere.

In several important ways, the candidates' speeches and web sites differ from the plans as we've outlined them above, and, in several cases, descriptions of proposals provided by campaign advisors strike us as implausible. Senator McCain has said repeatedly that he would repeal the individual AMT, allow businesses to expense all investments in equipment immediately, double the deduction for dependents, and give individuals the option to pay tax under a simplified alternative tax system. The campaign advisers say that the AMT will be patched but not eliminated except under the simplified alternative system, that only short-lived investments (for which expensing is not worth much) would qualify for immediate deduction, that the larger deduction for dependents would phase in slowly (and never equal twice the current-law deduction), and that the simplified alternative tax system would be revenue neutral. The last assertion is particularly questionable: few taxpayers will choose to pay an alternative tax if it does not reduce their tax bill, so an optional alternative is only revenue neutral if almost nobody elects it, which is probably not what the candidate has in mind. We estimated the cost of Senator McCain's plan as described on the stump, assuming that all the provisions are fully effective immediately and that the optional alternative tax system is similar to the one proposed by the Republican Study Committee. Under those assumptions, the revenue loss attributable to the Senator's plan increases to almost $7 trillion over the 10-year budget window.

Senator Obama says he would subject high-income taxpayers to additional taxes "in the range of 2 to 4 percentage points more in total (combined employer and employee)" starting "a decade or more from now"[2] to help shore up Social Security. Nonetheless, his campaign advisers insist that there is no specific proposal. We estimated the cost of Senator Obama's proposals assuming that the Social Security proposal would impose a 2 percent income tax surtax on adjusted gross incomes over $250,000 and a 2 percent payroll tax paid by employers on employees' earnings

[2] "The Tax Facts: The Truth about the Obama Tax Plan" on the campaign's website at http://www.barackobama.com/pdf/taxes/Tax_Plan_Facts_FINAL.pdf (viewed August 15, 2008).

above that threshold and that all of the provisions—including the higher payroll tax—are fully effective immediately. Under those assumptions, the Senator's proposals would reduce revenues by $2.6 trillion over 10 years, or about $390 billion less than the proposals as described by his campaign advisers.

We also present a *very preliminary* analysis of the health plans of each campaign. Senator McCain proposes to replace the current income tax exclusion of employer-paid health insurance premiums with a refundable income tax credit of $2,500 for individual coverage or $5,000 for family coverage, whether acquired at work or purchased in the individual nongroup market. (The current exclusion of employer-paid premiums from payroll taxes would continue.) He would also establish a special high-risk pool to enable individuals with chronic health conditions to purchase health insurance. Senator Obama would provide subsidies that decrease with income for low- and middle-income families to help them purchase insurance in a new nongroup purchasing pool, mandate health insurance coverage for children, penalize employers who fail to provide health insurance to their employees, expand public health insurance programs for poor children and families, and provide subsidies for small employers that offer health insurance.

As noted below, important details of both plans are not known, so we made assumptions that might or might not be consistent with the final plans proposed by each campaign. Under our assumptions, if the plans took effect in 2009, the McCain plan would cost about $1.3 trillion over ten years and the Obama plan would cost about $1.6 trillion. Both campaigns propose measures that they believe will reduce the rate of growth of health insurance premiums, which would reduce the cost of their new subsidies and existing public programs. We did not evaluate the effectiveness of those measures and did not include savings from health care cost efficiencies in our estimates. Under our assumptions, Senator Obama's plan would reduce the number of uninsured Americans by about 18 million in 2009, and 34 million in 2018. Almost all children would have coverage because the law would require it, but nearly 33 million adults would still lack coverage in 2018. Senator McCain's plan would have far more modest effects, reducing the number of uninsured by just over 1 million in 2009, rising to a maximum of almost 5 million in 2013, after which the number of uninsured would creep upward because the tax credits grow more slowly than premiums. Both plans are highly progressive, although Senator Obama's plan targets subsidies more toward low- and middle-income households and is thus significantly more progressive than Senator McCain's proposal.

Both campaigns have complained that our analysis is incomplete because we fail to consider the effects of their spending cuts on the budget. The Congressional Budget Office (CBO) projects that the federal budget will run a cumulative deficit of $2.3 trillion over the 2009-2018 period under current law (see Summary Table 1).[3] If federal spending evolves as CBO predicts, the proposed tax cuts would add to those deficits and substantially increase the national debt. Senator Obama's plan as described by his economic advisers would increase the ten-year cumulative deficit by about $3.6 trillion to $5.9 trillion; Senator McCain's plan would boost it by $5.1 trillion to nearly $7.4 trillion. Adding to their plans proposals made in stump speeches but not confirmed by campaign advisors would lower the cumulative deficit over the decade slightly to $5.4 trillion for Obama and raise it to almost $11 trillion for McCain. Beyond this, the health

[3] See Summary Table 1 in Congressional Budget Office, *The Budget and Economic Outlook: An Update*, September 2008 (http://www.cbo.gov/ftpdocs/97xx/doc9706/09-08-Update.pdf).

Summary Table 1

Deficit Projections for Candidates' Tax Plans, 2009-2018

(billions of current dollars)

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009-2018
CBO Baseline											
Baseline	-438	-431	-325	-126	-147	-170	-162	-207	-174	-135	-2,313
Tax Plans as Described by Campaign Advisors											
Obama	-448	-517	-565	-459	-520	-581	-615	-705	-722	-737	-5,867
McCain	-548	-591	-671	-604	-662	-662	-765	-901	-958	-1,014	-7,373
Tax Plans as Described in Stump Speeches											
Obama	-427	-484	-525	-417	-473	-531	-559	-645	-656	-666	-5,381
McCain	-827	-884	-983	-915	-988	-1,086	-1,160	-1,296	-1,363	-1,433	-10,934

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6), various JCT scores, CBO's 2007 Budget Options, the fiscal year 2009 Treasury blue book, CBO's September 2008 budget projections, and CBO's debt service model.

Note: Estimates combine CBO's September 2008 projections of the federal budget deficit with TPC's estimates of revenue changes that would result from the candidates' tax plans. **They do not include any spending reductions proposed by the candidates.**

proposals and campaign promises not in the official descriptions could increase the costs still further.

Both candidates claim, however, that they will reduce spending below CBO's baseline, which would shrink the deficits. Indeed, Senator McCain recently promised to balance the budget by 2013 through sharp cuts in discretionary spending (including defense) and entitlements, although that was before the new, bleaker, CBO projections. Both candidates promise to eliminate earmarks and make the government more efficient and both expect to save billions by making the health care market work more effectively. Each candidate claims that he will rein in spending more than his opponent. Senator McCain points to the proposals made by Senator Obama for expansions in health care, education, and infrastructure. Senator Obama says that he will cut military spending by extricating us from Iraq sooner than Senator McCain would. Bringing the federal budget into balance would, however, require unprecedented spending cuts under either candidate's tax plan. For example, given the tax cuts described in his stump speeches, Senator McCain would have to cut federal spending in 2013 by more than 25 percent to balance the budget.

Finally, Senator McCain's advisors have pointed out that the budget situation could improve if his proposals lead to more economic growth. However, if the tax cuts substantially raise the national debt, the increase in borrowing by the federal government could crowd out private investment and consumers' purchases of homes and durable goods, which could slow the economy.

The rest of this report details our analysis. Section I describes how we obtained information about the candidates' tax plans, explains how we performed our modeling and analysis, and summarizes changes from our earlier analyses. Section II outlines the major tax proposals and estimates both their effect on revenues and economic activity, and on the distribution of tax burdens. Section III explores the revenue and distributional effects of the proposals as presented by the candidates. Section IV presents a very preliminary analysis of the candidates' health plans.

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 rarely contain enough technical detail to analyze proposals fully. In addition, the candidates' plans are often works in progress that change during the campaign.

Because it is important for the public to understand as much as possible how a candidate's tax proposals would affect them, their neighbors, and the broader economy, we have filled in the blanks with 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.

We present two versions of the proposals. Our main analysis is based on the nonhealth tax proposals as described by each campaign's economic advisers (with missing details filled in). We also show how the revenue and distributional effects might change if some proposals made by candidates on the stump—but not validated by the economic advisers—were enacted. The latter analysis often required us to make many more assumptions.

Particular uncertainty surrounds the health proposals. Senator Obama has not specified such important details as how the subsidy scheme for lower-income families would work and the tax rate imposed on companies that fail to offer health insurance to their workers. Senator McCain has a fairly specific proposal for a refundable tax credit for health insurance but has provided no details about how the high-risk pool for individuals with chronic health conditions would function. In each case, these details could have substantial effects on both health insurance coverage rates and the budgetary cost of the proposals. We estimate the effects of proposals that are consistent with the details provided by the campaigns, but the final proposals will likely differ in important respects from what we simulated.

We intend our estimates to conform as closely as possible to those that would be produced by the official government estimators. We assume that taxable income responds to marginal tax rates—that is, when faced with higher rates, taxpayers act to shelter more income from tax or shift the timing of income to reduce tax liability. We also assume that the estate tax serves as a backstop to the income tax, reducing the profitability of schemes to defer income tax liability. For that reason, proposals to cut the estate tax from current-law levels in 2011 would reduce both income and estate tax liabilities. Since our June 20 report, we have made several refinements to our estimates to make them more comparable with official estimates, including incorporating behavioral responses in our estate tax estimates and revising our estimates of the effects of changing corporate and individual income tax rates and bases. This update incorporates additional detail provided by the Obama campaign about their tax plan on August 14, 2008.[4]

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 2001–2006 tax cuts expire as scheduled after 2010 and nothing is done about the AMT. In contrast, the administration's baseline assumes enactment of all of the president's tax proposals, including permanent extension of the tax cuts, but only a one-year fix for the AMT in 2008. We estimate the cost of the plans against two baselines: current law (as described above) and current policy, in which both the Bush tax cuts and the AMT patch are extended.

We also estimate revenue for each plan as a share of GDP, which is independent of the baseline used. This measure shows the size of government that could be sustained under each candidate's tax plan 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 18.2 percent of GDP.

[4] The campaign posted the new description of their tax plan at http://origin.barackobama.com/taxes/

II. Analysis of proposals as described by campaign staff

In this section, we analyze the two candidates' proposed tax plans using details provided by the campaigns' economic advisers combined with additional assumptions needed to model the proposals fully. We assume that all proposals would take effect January 1, 2009, unless the campaign has specified an alternative schedule.[5] 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. *Description of the Plans*

1. Senator McCain's Plan[6]

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 made permanent the saver's credit and higher limits on contributions to tax-favored retirement savings accounts.) 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 increase 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 otherwise untaxed items (including personal exemptions, state and local tax deductions and certain other deductions) to their taxable income and disallows some tax credits, but taxpayers may also claim 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

[5] We assume Senator McCain's proposal to increase the estate tax exemption to $5 million and reduce the estate tax rate to 15 percent would take effect January 1, 2010.

[6] Senator McCain's chief economic advisor, Doug Holtz-Eakin, outlined the major elements of the candidate's tax plan, as well as the Senator's plan to cut spending at http://www.washingtonpost.com/wp-dyn/content/article/2008/07/13/AR2008071301643.html.

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 pay income taxes under an optional alternative tax system (see section III).

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.[7] Although billed as a doubling of the exemption, the $7,000 exemption would be only two-thirds higher than the level we project under current law in 2016 ($4,200).

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 is not indexed for inflation until 2017 and would phase down at a rate of $100 for each $1,000 (or fraction thereof) in excess of $50,000, but not below the level set for all taxpayers. Thus, even for lower-income married filers, the doubled exemption only applies (approximately) in the first year.

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 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.

[7] 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.

Table 1. Summary of the Major Provisions of the McCain and Obama Tax Plans

	John McCain	**Barack Obama**
2001/2003 Tax Cuts	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
Estate Tax	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
AMT	Permanently index 2007 AMT exemption; increase exemption by additional 5 percent per year after 2013 (temporarily)	Extend and index 2007 AMT patch
New Tax Cuts	Increase the dependent exemption by two-thirds (phased in)	Refundable "Making Work Pay Credit" of 6.2 percent of up to a maximum of $8,100 of earnings
	Reduce the maximum corporate income tax rate from 35 to 25 percent (phased in)	Refundable "Universal Mortgage Credit" of 10 percent of mortgage interest for nonitemizers
	Allow first-year deduction of 3- and 5-year equipment, deny interest deduction (expires)	Eliminate income tax for seniors making less than $50,000 per year
	Convert R&D credit to 10 percent of wages incurred for R&D, make permanent	Extend childless EITC phase-in range, increase phase-out threshold
	Suspend federal gas tax for summer 2008	Increase EITC phase-in rate to 45 percent for families with three or more children
		Increase to $5,000 the add-on to EITC phase-out threshold for married filers
		Make CDCTC refundable and increase maximum credit rate to 50 percent.
		Make saver's credit refundable and change formula to 50 percent match up to $1,000 of contributions
		Make permanent R&D credit and renewable energy production tax credit
		Mandate automatic 401(k)s and automatic IRAs
		Increase Hope credit: 100% match rate on up to $4,000
Health	Replace income tax exclusion for employer-sponsored insurance with refundable credit of $2,500 for individuals and $5,000 for families	Income-related subsidies for health insurance purchased through new health insurance exchange
		Pay or play for employers
Tax Increases	Repeal domestic production activities deduction	Increase maximum tax rate on capital gains and qualified dividends to 20 percent
	Eliminate oil and gas loopholes	Tax carried interest as ordinary income
	Unspecified corporate base broadeners	Eliminate oil and gas loopholes
		Tax publicly traded financial parts. as C corps.
		Codify economic substance doctrine
		Reallocate multinational tax deductions
		Require information reporting of basis for gains
Simplification	Create optional alternative tax with two rates and larger standard deduction and personal exemption	Provide taxpayers with simple returns the option of pre-filled tax forms to verify and sign.

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 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 deduct in the year placed in service (i.e., 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. Expensing is equivalent to eliminating tax on the normal return to investment. To limit the ability of companies to engage in tax "arbitrage" by offsetting tax-free capital investment with fully deductible debt, 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 increased debt and the specific additional investment it finances when firms invest in both depreciable and expensed assets.

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 take place before the presidential election, so we exclude it from our analysis.[8]

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. (The exclusion from payroll taxes would be preserved for employer-sponsored insurance.) 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 consumer price index for all urban consumers (CPI-U), the measure used to index other parameters in the tax code. Alternative policy proposals have suggested indexing new health insurance credits and deductions to a measure of medical prices, rather than to overall prices using the CPI-U. If the tax credit exceeds the actual premium, the excess will be deposited in the recipients' Health Savings Account.

Senator McCain also proposes to make insurance available to those who cannot gain coverage in the individual nongroup market through a subsidized high-risk pool, although no details are available about how that would work. In addition, Senator McCain has proposed to allow insurers to sell insurance across state lines. (We have not modeled these two elements.)

2. 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 his campaign staff, 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 imposed on the highest income taxpayers. The maximum tax rate on capital gains and dividends would increase from 15 to 20 percent for taxpayers with adjusted gross income over $250,000 for married couples and $200,000 for others. (After 2010, this would represent a tax cut on dividends, which would be taxed at ordinary income rates up to 39.6 percent under current law.) Obama would also restore the phaseouts of personal exemptions and itemized deductions for high-income taxpayers ($250,000 joint; $200,000 others). 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.

[8] See "Quick Facts on the Gas Tax Holiday," http://www.taxpolicycenter.org/taxtopics/quick_gastax.cfm, for additional discussion of the economics of a gas tax holiday.

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 state estate taxes would remain deductible and not revert to a credit. We also assume no change in the gift tax.

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 would each claim the credit based on their own earnings.[9] 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 nonitemizers, up to a maximum credit of $800 (indexed after 2009).

New incentives for saving. 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

[9] 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.

would retain all other features of the current Hope credit, including the phaseout 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 used to calculate the credit for childless workers from the projected 2009 value of $5,910 to $6,300 in 2009, $6,800 in 2010, $7,100 in 2011, and $7,250 in 2012. The threshold at which the phaseout begins would be increased from its current 2009 level of $7,390 to $9,825 in 2009, $10,875 in 2010, $12,325 in 2011, and $14,500 in 2012. Both thresholds are indexed for inflation after 2012. He would double the phase-in and phaseout rates for childless workers who pay child support from 7.65 to 15.3 percent, increasing their maximum tax credit from $555 to $1,110 in 2012.[10] Obama would also increase the credit rate from 40 to 45 percent for taxpayers with three or more children, but keep their phaseout rate at 21.06 percent. Finally, the phaseout 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.[11] 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). To avoid a "cliff" effect, we assume that the exemption from income taxes would phase out over a $10,000 income range between $50,000 and $60,000.

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.

[10] 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.
[11] 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.

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, (8) reallocating multinational tax deductions, and (9) closing loopholes in the corporate tax deductibility of CEO pay. Combined with other as-yet-unidentified provisions, the campaign expects these provisions to raise $76 billion in revenue in 2009. Because not all provisions are identified, we cannot verify that revenue estimate. We assume that the amount would grow at the same rate as GDP throughout the 10-year budget window.

Health Care. Senator Obama would provide targeted refundable tax credits to low-income families without access to employer-sponsored insurance and public health insurance who buy insurance in a new insurance exchange, penalize employers who fail to provide health insurance to their employees, mandate health insurance coverage for children, require private family policies to cover children up to age 25, expand the state children's health insurance program (SCHIP) and Medicaid, and provide subsidies for small employers.

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.

B. *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.[12]

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

[12] But Senator McCain has said in campaign speeches that he would repeal the AMT. See Section III below.

largest tax cuts 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 C examines the effects on the distribution of tax burdens.

1. 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.

a. Individual Income Taxes

Senator McCain's plan would cut top marginal income tax rates substantially. 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 as 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, however, 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. That extension would reduce federal revenues by about $1.7 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 reported incomes in the long run, but expanding the child credit is unlikely to produce significant economic activity. Lower capital gains rates reduce the tax incentive to hold onto assets (the so-called lock-in effect) and partially offset the double-taxation of corporate income, but they also encourage increased tax sheltering by converting ordinary income to capital gains. Lower dividend tax rates also mitigate the double taxation of corporate income, but, like capital gains relief, they apply whether or not the corporation is actually paying any income tax. A better and less costly option would be to limit the tax relief on corporate stock to the amount of tax actually paid at the corporate level (Burman 2003).

Senator McCain would also permanently extend and increase 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

Table R1
Senator John McCain's Tax Proposals
As Described by Campaign Staff
Impact on Tax Revenue, 2009-18

	2009-13	2009-18
(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.	-584.6	-1,729.8
(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.	-382.5	-1,232.8
(3) Increase estate tax exemption to $5 million (unindexed), cut rate to 15%.	-156.2	-579.6
(4) Increase dependent exemption by $500 annually between 2010 and 2016 and index for inflation thereafter. Accelerate increase for joint tax units.	-41.7	-177.9
(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.	-231.4	-45.0
(8) Permanently extend and modify the R&D credit.	-51.5	-133.1
(9) Eliminate corporate welfare.	157.8	364.8
Unverifiable campaign-provided revenue estimate		
Total of all provisions	**-1,477.3**	**-4,170.5**
Addenda:		
Net revenue impact against tax cuts extended, AMT-patched baseline	-329.7	-595.8
Federal tax revenue as a share of GDP	17.6	17.6

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).

and thereby reducing the economic cost of the tax. But the provision is quite expensive: federal tax revenues would fall by about $1.2 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 tax owed under the AMT. Assuming the proposed phase-in schedule, the proposal would cost approximately $180 billion over the next 10 years.

b. 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 $730 billion over ten years if phased in as the McCain campaign has suggested. 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. However, the corporate tax rate would be 10 percentage points lower than the top individual income tax rate, which would encourage some high-income individuals to use closely held corporations as tax shelters, which would reduce the individual income tax base. (We assume that these two effects roughly cancel each other out.)

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.[13] 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 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 $45 billion over the next ten years,

[13] 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 attaching borrowing to other assets, 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.

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 would accelerate capital purchases to take advantage of expensing.

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 close to $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.

c. 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 and income tax revenues by approximately $580 billion over 10 years. It would cut estate tax revenues by 90 percent and 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). Under the proposal, only about 4,000 estates would be subject to the tax in 2011 (less than 0.2 percent of the 2.5 million adult decedents).

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.

d. Economic 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 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.

2. 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. The plan would create a number of new refundable tax credits—which benefit households with incomes too low to owe income tax—and significantly increase income taxes for high-income families.

a. Individual Income Taxes

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. Since 2001, inequality in the distribution of after-tax income has grown faster than inequality in the distribution of pretax 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 marginal tax rates and additional complexity.

Many provisions in Obama's plan share a common shortcoming in their use of phaseouts to limit their benefits and constrain revenue costs. Phaseouts 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 as heavily 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.)

In 2009 and 2010, high-income taxpayers would face higher marginal tax rates on both ordinary income and capital gains and dividends under Senator Obama's plan than under current law.

Table R2
Senator Obama's Tax Proposals of August 14, 2008:
Economic Advisers' Version (No Payroll Surtax)
Impact on Tax Revenue, 2009-18

	2009-13	2009-18
(1) Make permanent the EGTRRA child credit expansions, marriage penalty relief, 10/15/25/28% rates; increase Pease and PEP thresholds to $250,000 ($200,000 for unmarried individuals).	-307.5	-853.5
(2) Make permanent the 0%/15% tax rates on capital gains and qualified dividends for taxpayers with AGI under $250,000 ($200,000 unmarried). Impose 20% rate on gains and dividends for taxpayers above those thresholds, effective 01/01/09.	-24.0	-166.8
(3) Restore PEP/Pease with the increased thresholds in 2009-10; restore the 36/39.6% rates	71.7	71.7
(4) Extend and index the 2007 AMT patch	-379.9	-1,167.1
(5) Freeze 2009 estate tax law (exemption not indexed)	-76.6	-284.1
(6) Create "Making Work Pay Credit"	-323.7	-709.5
(7) Create "Universal Mortgage Credit"	-54.0	-125.7
(8) Mandate automatic 401(k)s and automatic IRAs, expand saver's credit	-92.3	-203.5
(9) Create "American Opportunity Tax Credit"	-58.2	-138.9
(10) Phased-in expansion of earned income tax credit	-19.3	-46.5
(11) Expand child and dependent care tax credit	-10.6	-22.8
(12) Exempt seniors earning less than $50,000 from income taxation with phase-in of tax for those with income between $50,000 and $60,000.	-35.4	-69.9
(13) Make permanent the R&D and renewable energy production credits	-56.6	-155.1
(14) Revenue-raisers	399.7	924.1
Unverifiable campaign-provided revenue estimate		
Total of all provisions	**-966.7**	**-2,947.6**
Addenda:		
Net revenue impact against tax cuts extended, AMT-patched baseline	180.9	627.1
Federal tax revenue as a share of GDP [1]	18.3	18.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).

(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.

After 2010, the proposal primarily would allow the Bush tax cuts for high-income taxpayers to expire as scheduled except that tax rates on capital gains would be higher, while those on dividends would be lower. 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. 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 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 the regressivity of payroll taxes and to encourage low-income people to work, but it does so at a substantial revenue cost—$710 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 for homeowners. 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 creates inequity between older and younger taxpayers with the same income. The benefit would phase out over a range of income; that extends the benefit of the exemption to taxpayers at higher income levels and thus raises the revenue cost. In addition, the phaseout 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 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 affect people's behavior. Extending the EITC phase-in range and phaseout threshold for childless workers would 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, raising marginal tax rates and after-tax income for more childless workers; both changes would potentially lead affected taxpayers to work less. Families with three or more children—for whom Obama would increase the EITC phase-in rate to 45 percent—could experience similar effects on work effort. The higher credit percentage would encourage more work by lower earners, but the extended phaseout range could depress work effort higher up the income scale. 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 the 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 increase in after-tax wages net of childcare costs for the poorest workers, who could benefit from the credit for the first time because it would become refundable. Further, the credit's impact on wages net of work costs could significantly increase the work effort of second earners in a family, who, as noted above, have been found to be more responsive than primary earners to changes in the after-tax wage. This provision could thereby both raise economic output and make the income tax more progressive.

Turning the currently nonrefundable 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 potentially adverse behavioral effects on work effort and saving. 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.

Obama's plan creates potentially large marriage penalties on high income earners because of the Senator's promise to avoid raising taxes for couples with income below $250,000 and single people with income below $200,000. Consider, for example, taxes on dividend income. Couples with income above $250,000 face a 20 percent rate; those with lower incomes have a maximum rate of 15 percent. For singles, the higher rate starts when income exceeds $200,000. Suppose two single people each have a $200,000 income, half from earnings and half from dividends. The tax rate on their dividends never exceeds 15 percent. If they marry, however, their total income exceeds the $250,000 threshold and the rate on their dividend income jumps to 20 percent. Depending on how the new rate is applied, marriage could raise their tax on dividends by as much as $10,000.

In some cases, the Obama plan would mitigate existing marriage penalties. Under current law, the phaseout of itemized deductions will return in 2011 with substantial marriage penalties because the income threshold for the phaseout is the same for married and single taxpayers. By

Expansion of Refundable Tax Credits

Senator Obama proposes a major expansion in refundable tax credits—that is, credits available to eligible households even if they have no income tax liability. The refundable portion of Obama's non-healthcare tax credits (the amount in excess of tax liability) would equal $648 billion over ten years. (See http://www.taxpolicycenter.org/t08-0191.) The credits would increase the percentage of households that do not owe income tax in 2009 from 38 percent under current law to 48 percent in the proposal. That percentage would decline over time as real incomes (and tax liability) grow.

By budget scorekeeping convention, the refundable portions of tax credits are treated as outlays—that is, the same as direct spending—rather than as tax reductions. Under current law, outlays on the earned income tax credit and the child tax credit (and several much smaller refundable credits) will total $406 billion from 2009 to 2018; Senator Obama's proposals would thus increase the total to $1,054, or almost 160 percent.

There's an interesting debate about refundable tax credits. On the one hand, some critics argue that "tax cuts are for taxpayers," meaning that refundable tax credits should not be part of the tax cut agenda. *The Wall Street Journal* editorial page once famously opined that people with incomes too low to owe income tax were "lucky duckies," undeserving of tax relief.

On the other hand, a lot of what we call tax cuts are really spending programs in disguise. Does it really make sense to provide subsidies for health care, homeownership, saving, education, etc., in such a way that the low-income people who most need assistance are automatically disqualified? For that reason, Batchelder, Goldberg, and Orszag (2006) argued that all tax subsidy programs should be converted to refundable credits.

While this debate rages, there seems to be general agreement that refundable credits are the way to go to expand health insurance coverage. President Bush proposed refundable credits several times before switching to his standard deduction for health insurance. Senator McCain's proposal (discussed below) is basically the president's, but provided as a refundable tax credit instead of a deduction. And Senator Obama's subsidy scheme is also fully refundable, and even more targeted at those with low incomes.

setting separate thresholds, Obama would reduce the magnitude of the consequent marriage penalty but not eliminate it. Obama's plan would also reduce the substantial marriage penalties created by the AMT, primarily because it would sharply decrease the number of taxpayers who owe the alternative tax. (McCain's plan would do more in this regard because it would provide greater AMT relief.)

Several provisions do not directly affect income tax revenues, but do affect households' utilization of tax subsidies and the way they interact with the tax system. 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, help only those taxpayers with relatively simple returns and the lowest compliance costs today. It would also significantly increase 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 in time to send out refund checks in a timely manner 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.

b. Corporate Taxes

Obama's proposal to make permanent the Research and Development (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 in R&D and the development of more renewable energy sources. Most economists believe, however, that credits for selected investments in renewable energy are a less cost-effective way of reducing global warming and dependence on imported oil than approaches that raise the price of fossil fuels (including the cap-and-trade proposals advanced by both Obama and McCain) and allow private markets to select the least costly ways of reducing fossil fuel use.

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 their behavior. 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. The Obama campaign is probably overstating how much revenue additional loophole-closing proposals can raise, however, particularly with regard to proposals to reduce revenue lost from taxpayers who conceal offshore income and exploit international differences in tax rates to shift income to low-tax jurisdictions. There is little hard knowledge about how much revenue is lost to these transactions and administrative efforts to control them are ongoing.

c. The Estate Tax

Freezing the estate tax at its 2009 levels (a $3 million exemption and a 45-percent tax rate) would 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. Under the proposal, about 8,000 estates would be taxable in 2011, or about 0.3 percent of decedents. 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.

d. Efficiency Consequences

Senator Obama’s plan would substantially increase the deficit compared with current law and would add $3.6 trillion to the national debt over ten years. Top marginal income tax rates and top capital gains tax rates would increase to their pre-2001 levels, but dividend tax rates would be 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 cutting less productive government spending, the economic costs will be lower, but the long-term gain in progressivity may also be diminished depending on which programs are cut.

3. 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 will climb rapidly over the next ten years, growing from $5.0 trillion in 2007 to $7.9 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 18.9 percent of GDP to 20.3 percent over that time interval while spending is expected to stay roughly constant at around 21 percent of GDP (Table R3), despite significant increases in mandatory spending (for Social Security, Medicare, and Medicaid). Discretionary spending (including war spending) and interest on the debt are projected to decline.

Table R3

Revenue Effect of Candidates' Tax Proposals as Described by Campaign Staff
Impact on Tax Revenue, 2009-2018

	Fiscal Year										Total
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2009-18
	Change in Tax Revenue Against Current Law (billions of dollars)										
Obama	-10	-84	-230	-309	-333	-352	-372	-394	-418	-445	-2,948
McCain	-109	-152	-326	-439	-452	-403	-487	-547	-601	-655	-4,171
	Change in Tax Revenue Against Current Policy (billions of dollars)										
Obama	18	-9	38	65	68	75	82	89	97	104	627
McCain	-80	-77	-57	-65	-51	24	-34	-64	-86	-106	-596
	Revenues Collected (percent of GDP)										
Obama	18.8	18.2	18.0	18.2	18.1	18.1	18.1	18.2	18.3	18.4	18.2
McCain	18.2	17.7	17.4	17.5	17.4	17.8	17.6	17.5	17.4	17.4	17.6
	Baseline Revenues and Outlays (percent of GDP)										
Current Law Revenues	18.9	18.7	19.4	20.0	19.9	20.0	20.0	20.1	20.2	20.3	19.8
Current Policy Revenues	18.8	18.3	18.1	18.2	18.0	18.1	18.1	18.1	18.2	18.3	18.2
CBO Baseline Outlays	21.5	21.4	21.4	20.7	20.9	20.9	21.0	21.3	21.2	21.0	21.1

Sources: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6), various JCT scores, CBO's Options, the fiscal year 2009 Treasury blue book, and CBO's September 2008 budget projections.

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 $3.6 trillion to the national debt (including additional interest costs) while Senator McCain's plan would add $5.1 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 18.1 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 17.4 percent. Given that demands on the federal government are likely to exceed historical levels in 2013 (CBO projects spending at 20.9 percent of GDP), these estimates imply that both plans would require substantial cuts in spending to balance the budget if all of the proposed tax cuts were enacted.

C. *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.

1. The Obama Plan

Effects in 2009. In 2009, Senator Obama's tax plan would, on average, provide a modest tax cut equal to 0.6 percent of after-tax income, or $331 (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 2.6 percent of income ($1,118). In contrast, taxes would rise by an average of 1.5 percent of income ($3,017) 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 7.0 percent of income or about $94,000. The top 0.1 percent—the richest 1 in 1,000—would face an average tax increase of nearly $550,000, or 8.9 percent of 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.

Table 1
Senator Obama's Tax Proposals of August 14, 2008: Economic Advisers' Version (No Payroll Surtax)
Distribution of Federal Tax Change by Cash Income Percentile, 2009

Cash Income Percentile[1,2]	Percent of Tax Units[3]		Percent Change in After-Tax Income[4]	Average Federal Tax Change ($)	Average Federal Tax Rate[5]	
	With Tax Cut	With Tax Increase			Change (% Points)	Under the Proposal
Lowest Quintile	67.8	7.7	5.5	-567	-5.3	-0.7
Second Quintile	86.1	8.4	3.6	-892	-3.2	7.5
Middle Quintile	93.3	5.7	2.6	-1,118	-2.2	14.7
Fourth Quintile	86.4	12.1	1.8	-1,264	-1.4	18.4
Top Quintile	76.6	22.3	-1.5	3,017	1.1	27.3
All	81.3	10.4	0.6	-331	-0.4	21.3
Addendum						
80-90	83.3	14.8	2.0	-2,135	-1.6	21.1
90-95	85.6	13.9	1.9	-2,796	-1.5	23.0
95-99	66.3	33.5	-0.1	121	0.0	26.5
Top 1 Percent	7.1	92.8	-7.0	93,709	5.0	34.5
Top 0.1 Percent	1.0	99.0	-8.9	542,882	6.1	37.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
Notes: Data are for calendar year 2009. Assumes provisions are fully phased in.
(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.

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 20 per cent. 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 most of 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). Because the distribution of capital income is highly concentrated at the top of the income scale, the corporate tax is highly progressive.[14] As a result, Senator Obama's corporate tax increases are borne primarily by households in the top quintile. However, taxpayers in the 80th through 95th percentiles benefit

[14] For more details, including information on the current-law distribution of the corporate income tax and other federal taxes, see Rohaly (2008).

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 80 percent of households would owe less tax while only about 10 percent would owe more. Again, outcomes would differ significantly by income. Only 6 percent of households in the middle of the income spectrum would face a tax increase. In contrast, 22 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.[15] 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 4.7 percent of income or $2,197.

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

Table 2
Senator Obama's Tax Proposals of August 14, 2008: Economic Advisers' Version (No Payroll Surtax)
Distribution of Federal Tax Change by Cash Income Percentile, 2012

Cash Income Percentile[1]	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
Lowest Quintile	68.2	7.5	6.2	-698	-5.8	-0.4
Second Quintile	87.9	6.6	5.9	-1,589	-5.1	8.0
Middle Quintile	96.2	2.9	4.7	-2,197	-3.8	15.4
Fourth Quintile	97.2	2.6	4.4	-3,356	-3.4	18.9
Top Quintile	93.3	6.7	2.0	-4,285	-1.4	27.2
All	86.7	5.5	3.4	-2,170	-2.6	21.4
Addendum						
80-90	97.0	3.0	4.4	-5,016	-3.3	21.7
90-95	96.9	3.1	3.8	-6,104	-2.8	23.3
95-99	87.4	12.5	2.3	-6,151	-1.6	26.5
Top 1 Percent	62.1	37.9	-1.5	19,274	1.0	34.1
Top 0.1 Percent	33.8	66.2	-2.8	163,423	1.8	37.5

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

[15] Provisions relating to select retirement savings incentives were made permanent by the Pension Protection Act of 2006 (P.L. 109-280).

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 2.0 percent of income or $4,285. 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, as well as the corporate tax increase 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 three-fifths 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 effects. Those at the top of the income scale would face much larger tax increases and households 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 2.2 percent of income or $1,035. Those in the top fifth of the income distribution would face an average tax increase of 3.0 percent of income, or $6,770. The top 1 percent would be hit by an average tax hike of 8 percent of income or more than $110,000.

Table 3
Senator Obama's Tax Proposals of August 14, 2008: Economic Advisers' Version (No Payroll Surtax)
Against a Tax Cuts Extended, AMT Patched Baseline
Distribution of Federal Tax Change by Cash Income Percentile, 2012

Cash Income Percentile[1]	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
Lowest Quintile	67.8	7.7	5.4	-617	-5.2	-0.4
Second Quintile	85.6	8.4	3.4	-950	-3.1	8.0
Middle Quintile	91.9	6.8	2.2	-1,035	-1.8	15.4
Fourth Quintile	81.9	15.2	1.0	-757	-0.8	18.9
Top Quintile	52.6	42.7	-3.0	6,770	2.2	27.2
All	76.6	14.2	-0.5	299	0.4	21.4
Addendum						
80-90	74.7	21.3	0.4	-442	-0.3	21.7
90-95	45.2	47.4	-0.3	448	0.2	23.3
95-99	17.6	78.0	-2.0	5,686	1.5	26.5
Top 1 Percent	4.8	95.0	-8.0	114,238	5.7	34.1
Top 0.1 Percent	0.5	99.5	-10.2	650,938	7.1	37.5

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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: 2.9 percent of income (table 4).[16] As a percent of after-tax income, married couples filing jointly would get the smallest tax cut: 0.2 percent of income. Single filers would receive a tax cut equal to 0.8 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 benefit most 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, are hit more by the provisions that raise taxes on upper-income earners, such as the higher statutory tax rates and the increases in the rates on capital gains and dividends.

Table 4
Senator Obama's Tax Proposals of August 14, 2008: Economic Advisers' Version (No Payroll Surtax)
Percentage Change in After-Tax Income For Various Demographic Groups
By Cash Income Adjusted for Family Size, 2009

Cash Income Percentile[1]	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children[2]	Elderly[3]
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	2.9	3.1	1.5
Fourth Quintile	2.4	2.1	2.5	2.2	3.2	1.5
Top Quintile	-1.5	-1.9	-1.3	-0.8	-0.9	-3.2
All	0.6	0.8	0.2	2.9	1.4	-1.4
Addendum						
80-90	1.9	0.6	2.3	1.5	3.1	0.0
90-95	1.4	-0.3	1.9	1.4	2.8	-0.4
95-99	0.0	-0.9	0.2	-0.8	-0.1	-1.3
Top 1 Percent	-6.9	-7.0	-6.8	-6.8	-7.2	-7.4
Top 0.1 Percent	-8.8	-9.4	-8.7	-8.8	-8.9	-9.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

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

[16] 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 7 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.

Households with children fare better than the population as a whole: they receive an average increase in after-tax income of 1.4 percent, more than double the figure for all households. This general result holds within quintiles as well, although to a lesser degree. 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 proposal making the child and dependent care credit refundable. At higher income levels, the extension of the AMT patch benefits those with children more because 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 more than 9 million senior households, over a third of the total (not shown in table). On average, seniors would face a tax increase of about 1.4 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 3.2 percent of income. Taxes would increase by an average 7.4 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 hurt the typical older taxpayer more than the typical younger taxpayer, who receives more of his or her income from earnings. For the same reason, higher-income seniors would on average see a larger drop in after-tax income from Obama's corporate tax increases than younger taxpayers.

The general pattern across demographic groups is much the same in 2012 as in 2009, although the average tax cuts are much larger because 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, 6.2 percent of income. Middle-income married couples and heads of household receive average benefits of 5.4 percent, slightly better than the 5.1 percent average for all middle-income households. Middle-income elderly fare the worst, receiving an average increase in after-tax income of only 3 percent.

2. 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

Table 5
Senator Obama's Tax Proposals of August 14, 2008: Economic Advisers' Version (No Payroll Surtax)
Percentage Change in After-Tax Income For Various Demographic Groups
By Cash Income Adjusted for Family Size, 2012

Cash Income Percentile[1]	Percentage Change in After-Tax Income: All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children[2]	Elderly[3]
Lowest Quintile	7.5	6.6	8.2	8.2	9.6	1.1
Second Quintile	6.4	4.7	7.0	7.6	9.0	1.7
Middle Quintile	5.1	4.4	5.4	5.4	6.2	3.0
Fourth Quintile	4.4	3.7	4.8	3.9	5.6	3.4
Top Quintile	2.0	2.5	1.9	1.7	2.1	1.7
All	3.4	3.6	3.1	5.3	4.4	2.1
Addendum						
80-90	4.0	3.5	4.2	3.0	4.4	3.6
90-95	3.6	3.5	3.7	2.8	4.0	3.7
95-99	2.5	3.8	2.3	1.4	2.0	3.1
Top 1 Percent	-1.3	-1.0	-1.3	-1.6	-1.4	-1.5
Top 0.1 Percent	-2.7	-3.4	-2.6	-3.1	-2.8	-3.1

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.

tax rate to 25 percent—that would phase in gradually over time.[17] 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 2012 income levels.

In 2009, the fully-phased-in McCain tax plan would, on average, provide a tax cut equal to 2.1 percent of after-tax income, or $1,230 (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 ($21) and those in the middle fifth of the income distribution would receive an average cut equal to 0.8 percent of income ($325). Households in the top quintile, however, would get an average tax cut of 3.2 percent of income ($6,498). For those in the upper portion of 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 3.7 percent of income or almost $50,000 and the richest 1 in 1,000 would see an average tax cut of more than $290,000 or 4.7 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

[17] The only element of the Obama plan that phases in over time is the increase in the earned income tax credit. The revenue and distributional effect of that provision is extremely small compared to the phased-in measures in the McCain plan. For consistency, our distribution estimates for the Obama plan assume the EITC measure is fully phased in.

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 benefit substantially only from the increased dependent exemption, but that increase would not benefit the lowest income households who 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 as Described by His Campaign Staff, Distribution of Federal Tax Change by Cash Income Percentile, 2009

Cash Income Percentile[1]	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
Lowest Quintile	17.6	0.0	0.2	-21	-0.2	4.4
Second Quintile	44.3	0.1	0.5	-118	-0.4	10.2
Middle Quintile	65.8	0.1	0.8	-325	-0.6	16.2
Fourth Quintile	84.6	0.0	1.4	-994	-1.1	18.7
Top Quintile	97.0	0.0	3.2	-6,498	-2.3	23.9
All	56.2	0.1	2.1	-1,230	-1.6	20.1
Addendum						
80-90	95.5	0.0	2.5	-2,584	-1.9	20.8
90-95	98.6	0.0	3.1	-4,437	-2.3	22.1
95-99	98.7	0.1	3.3	-8,159	-2.4	24.0
Top 1 Percent	98.0	0.1	3.7	-48,862	-2.6	27.0
Top 0.1 Percent	99.6	0.0	4.7	-290,708	-3.3	28.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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 be much more regressive in 2012 than in 2009 because expiration of the Bush tax cuts makes the baseline much more progressive.[18] 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 $1,441. The top fifth would receive an increase in after-tax income of 6.4 percent or $13, 909. 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 ($126,902) while the top 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.

Table 7
Senator John McCain's Tax Proposals as Described by His Campaign Staff, Distribution of Federal Tax Change by Cash Income Percentile, 2012

Cash Income Percentile[1]	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
Lowest Quintile	38.6	1.8	0.9	-101	-0.8	4.5
Second Quintile	88.9	1.1	2.8	-763	-2.5	10.6
Middle Quintile	98.1	0.2	3.1	-1,441	-2.5	16.7
Fourth Quintile	99.6	0.1	4.1	-3,110	-3.2	19.1
Top Quintile	99.9	0.1	6.4	-13,909	-4.6	24.1
All	81.0	0.8	4.9	-3,069	-3.7	20.3
Addendum						
80-90	99.9	0.1	4.8	-5,478	-3.6	21.4
90-95	100.0	0.1	4.8	-7,692	-3.6	22.5
95-99	99.9	0.0	5.3	-14,395	-3.8	24.3
Top 1 Percent	99.9	0.1	9.5	-126,902	-6.4	26.8
Top 0.1 Percent	100.0	0.0	11.6	-680,157	-7.4	28.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

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 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

[18] For estimates of the distribution of the 2001–06 tax cuts, see Leiserson and Rohaly (2006), Leiserson and Rohaly (forthcoming) and the TPC web site at http://www.taxpolicycenter.org/taxtopics/cuts0106.cfm.

McCain. And, except for those at the very top, higher income households benefit most from the extension of the AMT patch proposed by the Senator.[19]

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 of 0.9 percent of income or $601 (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 corporate tax cuts would benefit most those at the top and, along with the increased dependent exemption, would cause those in the highest quintile to get an average cut of 1.3 percent of income.

Table 8
Senator John McCain's Tax Proposals as Described by His Campaign Staff against a Tax-Cuts-Extended, AMT-Patched Baseline, Distribution of Federal Tax Change by Cash Income Percentile, 2012

Cash Income Percentile[1]	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
Lowest Quintile	17.8	0.0	0.2	-21	-0.2	4.5
Second Quintile	45.2	0.2	0.5	-124	-0.4	10.6
Middle Quintile	63.5	0.1	0.6	-282	-0.5	16.7
Fourth Quintile	78.6	0.0	0.7	-513	-0.5	19.1
Top Quintile	87.7	0.1	1.3	-2,856	-0.9	24.1
All	53.7	0.1	0.9	-601	-0.7	20.3
Addendum						
80-90	86.7	0.0	0.8	-906	-0.6	21.4
90-95	88.7	0.1	0.7	-1,142	-0.5	22.5
95-99	86.9	0.1	0.9	-2,560	-0.7	24.3
Top 1 Percent	96.2	0.2	2.2	-31,943	-1.6	26.8
Top 0.1 Percent	99.1	0.4	3.0	-192,645	-2.1	28.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

[19] Because the top rate in the regular income tax of 35 percent exceeds the top statutory AMT rate of 28 percent, very high income households that do not engage in substantial sheltering pay tax under the regular tax system. See Leiserson and Rohaly (2008) for details.

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 1.6 percent of income.

Married couples receive the largest average tax cut because they are most likely to be in the top income groups that benefit most from the McCain tax plan. In contrast, heads of household are concentrated 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 singles in the second through fourth quintiles receive much smaller than average increases in their after-tax income than married taxpayers or heads of household.

The increase in the dependent exemption also results in above-average tax cuts for households with children, except in the bottom quintile, where the increased exemption has little effect. Unlike the Obama plan, the McCain plan cuts taxes for the elderly more than for others: their after-tax incomes would rise by an average of 3.0 percent. But only the high-income elderly, who

Table 9

Senator John McCain's Tax Proposals as Described by His Campaign Staff, Percentage Change in After-Tax Income for Various Demographic Groups by Cash Income Adjusted for Family Size, 2009

Cash Income Percentile[1]	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children[2]	Elderly[3]
Lowest Quintile	0.2	0.2	0.3	0.0	0.1	0.3
Second Quintile	0.7	0.4	0.7	1.0	1.0	0.5
Middle Quintile	1.0	0.4	1.2	1.5	1.7	0.7
Fourth Quintile	1.6	0.4	2.0	1.9	2.8	1.0
Top Quintile	2.8	3.1	2.8	2.5	3.0	4.4
All	2.1	1.6	2.3	1.4	2.5	3.0
Addendum						
80-90	2.0	0.7	2.4	2.1	3.4	1.9
90-95	2.3	1.2	2.7	2.2	3.5	2.5
95-99	2.9	3.0	2.9	2.4	2.5	4.3
Top 1 Percent	3.8	7.4	3.0	3.3	2.7	6.6
Top 0.1 Percent	4.9	9.3	4.1	4.4	3.8	7.8

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

have significant amounts of capital income, benefit disproportionately from the tax cuts, primarily because of 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).

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 4.0 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 earned income tax credit, and marriage penalty relief. 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, but this relatively larger gain in after-tax income for the elderly occurs only for the top quintile.

Table 10
Senator John McCain's Tax Proposals as Described by His Campaign Staff,
Percentage Change in After-Tax Income for Various Demographic Groups
by Cash Income Adjusted for Family Size, 2012

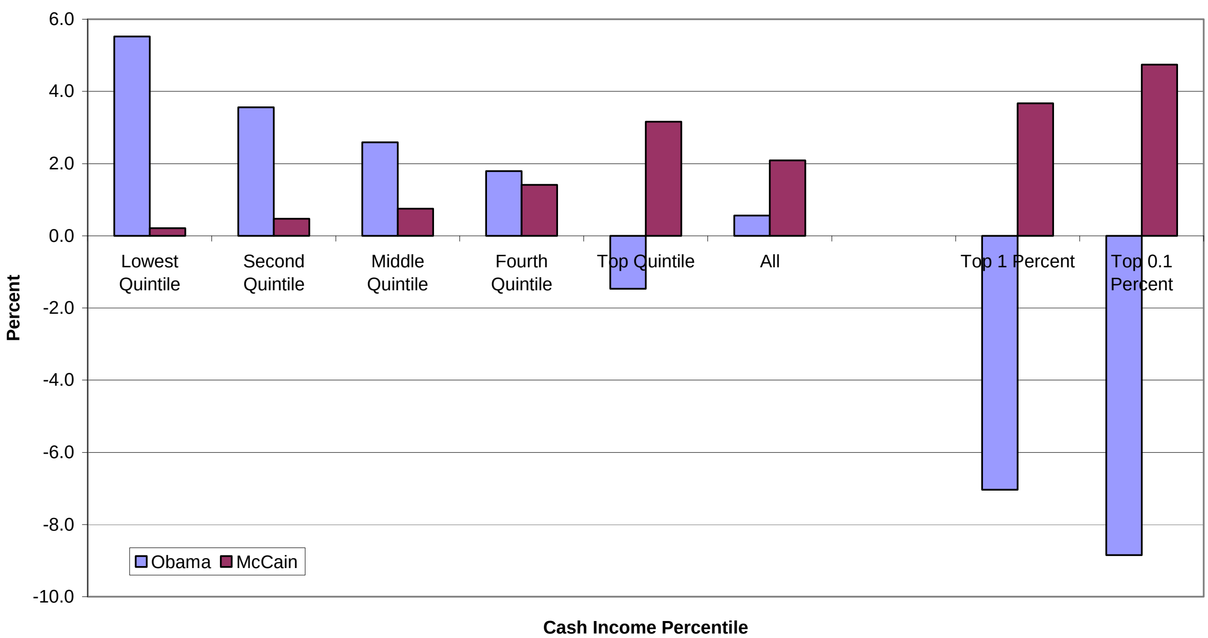
Cash Income Percentile[1]	Percentage Change in After-Tax Income					
	All Tax Units	Single Individuals	Married Couples Filing Jointly	Heads of Household	Tax Units with Children[2]	Elderly[3]
Lowest Quintile	1.4	0.5	2.6	1.5	2.4	0.5
Second Quintile	3.3	1.6	3.9	4.6	5.4	1.2
Middle Quintile	3.3	1.9	3.9	4.2	5.0	2.1
Fourth Quintile	3.7	2.4	4.3	3.8	5.4	3.4
Top Quintile	6.1	7.4	5.7	4.6	5.8	9.0
All	4.9	4.3	5.2	4.0	5.4	6.3
Addendum						
80-90	4.1	3.7	4.3	3.4	4.7	5.4
90-95	4.4	4.8	4.3	3.5	4.6	6.5
95-99	5.2	7.6	4.6	3.9	4.3	8.5
Top 1 Percent	9.6	14.3	8.6	8.7	8.9	12.8
Top 0.1 Percent	11.6	17.2	10.7	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.

3. 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 as Described by Campaign Staff and Economic Advisers
Average Percentage Change in After-Tax Income, 2009



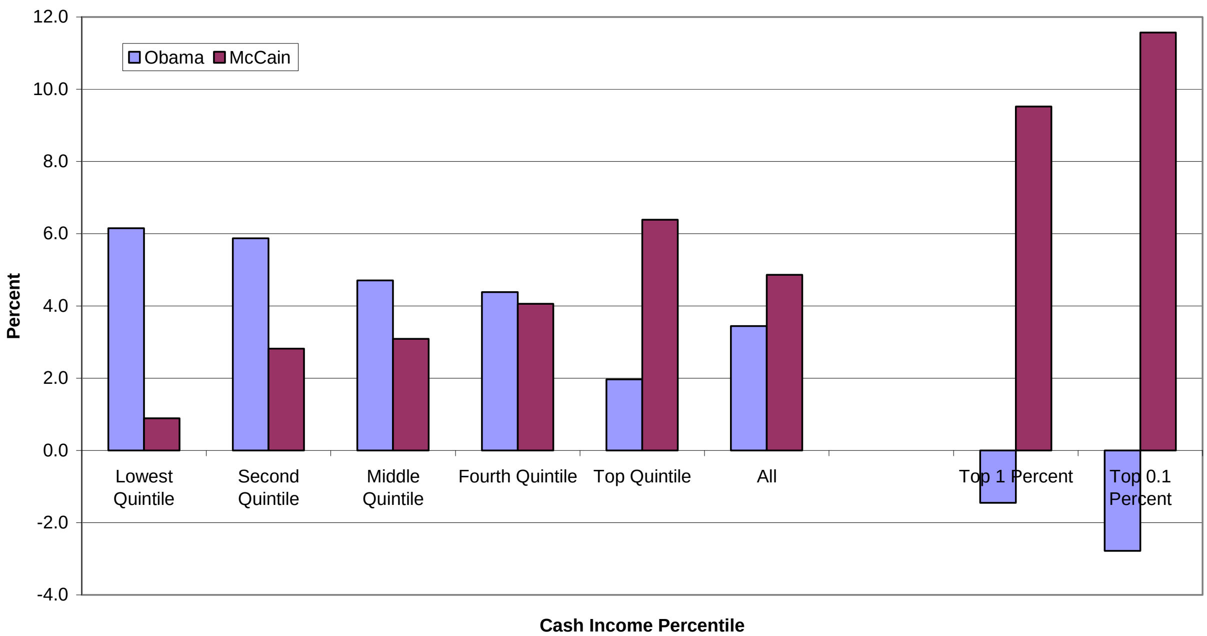
Notes: All provisions are assumed to be fully phased in. Obama proposal does not include payroll surtax.

Measured against current law in 2009, Senator Obama's plan raises after-tax incomes by 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 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 7 percent of after-tax income for the top 1 percent of households and 8.9 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 3.7 percent. That figure rises to almost 4.7 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 as Described by Campaign Staff and Economic Advisers
Average Percentage Change in After-Tax Income, 2012



Notes: All provisions are assumed to be fully phased in. Obama proposal does not include payroll surtax.

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 1.5 percent of income; that figure would rise to nearly 3 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 2001–06 tax cuts for higher income earners and recipients of capital gains and dividends (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.

III. The candidates' tax plans as described by the candidates

In several important ways, the tax plans described in the candidates' speeches and on their web sites differ from the plans as we've outlined above and, in several cases, descriptions of proposals by campaign advisors strike us as implausible. Senator McCain's proposals on the stump are often far more sweeping than the more measured options outlined by his campaign. Senator Obama also often proposes new taxes on high-income households to extend Social Security solvency, but his staff insists that no specific policy exists. Since it is at least possible that campaign promises made by the candidate himself might translate into legislation if he is elected, we have tried to estimate versions of each candidate's tax plans that are more consistent with the candidate's public statements. We also estimate the cost of all provisions assuming that they are both effective immediately and permanent because that combination provides a better measure of their long-term effect on public finances.

Expansions of McCain's Tax Plan

In stump speeches, Senator McCain has proposed complete repeal of the AMT, a broader expansion of expensing of investments, and allowing taxpayers to use an alternative, simplified system to calculate their income taxes.

AMT. According to the McCain campaign, Senator McCain would permanently extend and index the AMT patch as enacted in recent years, plus allow for faster increases in the AMT exemption beginning in 2014. However, his public statements always suggest that he plans to repeal the tax. Accordingly, we assume full repeal effective in 2009.

Expensing. The campaign indicates that expensing would apply only to three- and five-year equipment and only on a temporary basis. Since expensing is simply a speed up of deductions that would be allowed eventually, the long-lived assets excluded from this specification are the ones for which expensing would be most beneficial (and most costly to the government). Senator McCain's public statements strongly imply that the provision would apply to all machinery and equipment.

Simplified Alternative Tax System. Senator McCain routinely promises to allow taxpayers to figure their taxes under an optional alternative tax system. 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 specifics, but we judge the notion of a revenue-neutral and optional alternative tax system as implausible. Offering taxpayers an option to pay taxes under an alternative system would almost certainly cost the Treasury money. Although some taxpayers might choose to pay additional tax in exchange for a simpler return, most taxpayers would elect the alternative system only if it cuts their tax bill. The few who would opt to pay a higher alternative tax would likely pay little additional tax.[20] Furthermore, if the new alternative tax system does not offer

[20] Indeed, if taxpayers were willing to pay higher taxes to simplify their returns, they could simply skip all deductions, exemptions, and credits under the current system. Relatively few taxpayers choose to do so.

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. Nonetheless, it seems unlikely that the candidate intends an alternative system that almost nobody would choose and which would be revenue neutral only because some taxpayers are confused into making an irrevocable election that they would later regret.

The publicly provided details of the plan are limited. At times the alternative system has been described as having two rates of 10 (or 15) and 25 percent, a broad tax base, no itemized deductions, and larger personal exemptions and standard deductions. We assume rates of 15 and 25 percent and that the alternative tax base would equal AGI plus tax-exempt interest, untaxed Social Security, and the deductions for educator expenses, health saving accounts (HSAs), retirement savings, student loan interest, tuition and fees. The alternative tax would have a standard deduction of $10,000 ($20,000 for married couples) and personal exemptions of $4,000. The 15 percent rate would apply to income up to $50,000 ($100,000 for couples) and the 25 percent rate would apply to income above that level.[21] The alternative system would retain reduced rates for capital gains and dividends. To account for the fact that choosing the alternative tax could lock the taxpayer into that system in future years, we assume that taxpayers choose the alternative system only if it reduces their current tax liability by at least 10 percent.[22]

Expansions of Obama's Tax Plan

In campaign speeches, Senator Obama has proposed increasing payroll taxes for high-income individuals but his campaign denies having a particular policy relating to payroll taxes. The campaign's website says that Senator Obama would increase taxes on high-income individuals as a way to extend the solvency of Social Security. Lacking specifics, we assume an additional two percent income tax on AGI above $250,000 and a two percent payroll tax paid by employers on each worker's compensation above $250,000).[23]

A. *Revenue Effects under the Expanded Policies*

Under our alternative assumptions, Senator McCain's plan becomes much more expensive, reducing federal tax revenues by almost $7 trillion over the ten-year budget period—two-thirds more than the plan described by McCain's campaign staff (table R4). Repealing the AMT would reduce revenues by about $390 billion beyond the cost of the patch proposal. Applying expensing to all machinery and equipment investments would cost about $740 billion more than the temporary and limited proposal to allow expensing of three- and five-year property assumed in the previous section. Increasing the dependent exemption to $7,000 immediately rather than in 2014 would cut revenues an additional $240 billion. Reducing the corporate tax rate to 25

[21] The tax bracket thresholds, standard deduction, and personal exemption values would be indexed for inflation after 2009.
[22] This plan is very similar to one proposed by the Republican Study Committee and endorsed by Senator Thompson. See Burman, Leiserson, and Rohaly 2008.
[23] We assume the same thresholds for married couples and unmarried individuals.

percent immediately would reduce revenues by $260 billion. Finally, after all the other changes have been made, the optional alternative tax system that we model would reduce income tax revenues by almost $1.2 trillion over ten years. Including added debt service of nearly $1.7 trillion on the lost revenue would bring the total increase in federal debt to $8.6 trillion over ten years.

Table R4
Senator John McCain's Tax Proposals as Described in His Stump Speeches, Impact on Tax Revenue, 2009-18

	2009-13	2009-18
(1) Proposals as described by economic advisers	-1477.3	-4,170.5
Potential additional cost of proposals compared with economic advisers version		
(2) Repeal AMT rather than patch and index	-177.1	-391.2
(3) Increase dependent exemption to $7,000 in 2009 and index	-142.3	-243.3
(4) Reduce corporate income tax rate to 25% immediately	-249.8	-259.5
(5) Allow full expensing of all business	-317.5	-737.8
(6) Alternative individual income tax system with rates of 15%/25%	-470.9	-1,151.2
Total change compared with economic advisers version	**-1,357.5**	**-2,783.0**
Total of all provisions	**-2,834.9**	**-6,953.5**
Addenda:		
Net revenue impact against tax cuts extended, AMT-patched baseline	-1,687.3	-3,378.8
Federal tax revenue as a share of GDP under the proposal	16.0	16.1

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).

In contrast, the expanded version of Senator Obama's plan would reduce the revenues by $2.6 trillion over ten years, nearly $400 billion less than under the plan described by his advisers (table R5) [24]. The difference comes from the additional payroll tax on high-income taxpayers.

[24] Because of rounding – this number looks larger than those reported in the tables..

Although the campaign says it would not take effect "for at least ten years," we calculate how much the government would collect if the tax increase took place immediately. Similarly, we estimate the cost of the EITC expansions as if they were fully effective in 2009. Including added debt service of $510 billion on the lost revenue would boost the total increase in federal debt to $3.1 trillion over ten years.

Table R5
Senator Obama's Tax Proposals of August 14, 2008:
Stump Speech Version (With Payroll Surtax)
Impact on Tax Revenue, 2009-18

	2009-13	2009-18
Proposals as announced by economic advisers	-966.7	-2,947.6
(1) Additional cost of fully phased in proposals		
Expand earned income tax credit, fully phased in for 2009	-2.9	-2.9
(2) Additional revenue from payroll surtax, fully phased in		
Payroll surtax of 2 percent (paid by employers only) of earnings over $250,000, indexed after 2009; plus surtax of 2 percent of AGI in excess of $250,000, indexed after 2009.	170.6	396.1
Total change compared with version announced by economic advisers	165.1	390.2
Total of all stump speech provisions, fully phased in	**-801.5**	**-2,557.4**
Addenda:		
Net revenue impact against tax cuts extended, AMT-patched baseline	346.1	1,017.3
Federal tax revenue as a share of GDP under the proposal	18.5	18.4

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
Notes: 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.

B. *Distributional Effects of the Expanded Policies*

Senator McCain's plan, as modeled here to reflect his own public statements, reduces taxes across the board, but the largest tax cuts accrue to those with very high incomes (table 11). In 2009, the average tax cut of $2,250 is almost double the $1,230 tax cut under the economic advisers' version. Some lower-income taxpayers benefit from the large cuts in corporate income taxes, but most of the benefits go to those at the top, who receive a disproportionate share of income from capital. Repealing rather than simply reducing the AMT also primarily benefits taxpayers with high incomes. The higher dependent exemption helps most taxpayers with children, but those in the top tax brackets again benefit most. Finally, the optional alternative tax system, as we modeled it, provides the largest benefit to those who owe the most tax under current law—those with very high incomes. Overall, the tax cuts would increase after-tax income by 0.6 percent for the lowest quintile, 1.4 percent for the middle quintile, and 5.9 percent for those in the top quintile. At the very top of the income distribution, the richest 1 in 1,000 taxpayers would receive an average tax cut of 9.4 percent of income, or $577,000. That is twice the tax cut that they would get under the more modest plan outlined by Senator McCain's economic advisers.

Table 11
Senator John McCain's Tax Proposals as Described in His Stump Speeches, Distribution of Federal Tax Change by Cash Income Percentile, 2009

Cash Income Percentile[1]	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
Lowest Quintile	29.2	0.0	0.6	-65	-0.6	3.9
Second Quintile	70.7	0.1	1.0	-259	-0.9	9.7
Middle Quintile	84.3	0.3	1.4	-608	-1.2	15.7
Fourth Quintile	92.6	0.0	2.1	-1,487	-1.7	18.2
Top Quintile	98.7	0.0	5.9	-12,144	-4.4	21.9
All	70.3	0.1	3.8	-2,250	-3.0	18.7
Addendum						
80-90	97.8	0.0	3.6	-3,736	-2.8	20.0
90-95	99.5	0.0	4.4	-6,322	-3.3	21.1
95-99	99.7	0.0	6.3	-15,877	-4.7	21.8
Top 1 Percent	99.8	0.0	8.2	-109,214	-5.8	23.8
Top 0.1 Percent	100.0	0.0	9.4	-577,148	-6.5	24.9

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

Senator Obama's plan, as we model it to include the payroll tax increase, would have a large impact on very high income taxpayers too, but in the opposite direction. In 2009, the top 1 percent of households would experience an average tax increase equal to 9.1 percent of income, or more than $120,000 (table 12), compared with 7 percent—about $94,000—under the economic advisers' version. The richest 1 in 1,000 households would face an average tax increase of 11.4 percent of income, or almost $700,000. At the other end of the income distribution, households in the bottom four quintiles would receive the same average tax reductions as under the campaign advisers' version of the plan. Overall, more than 80 percent of households would receive a tax cut under the plan, but the overall net tax cut would drop by nearly a third from $331 under the advisors' version to $96 with the higher payroll tax for upper-income earners,

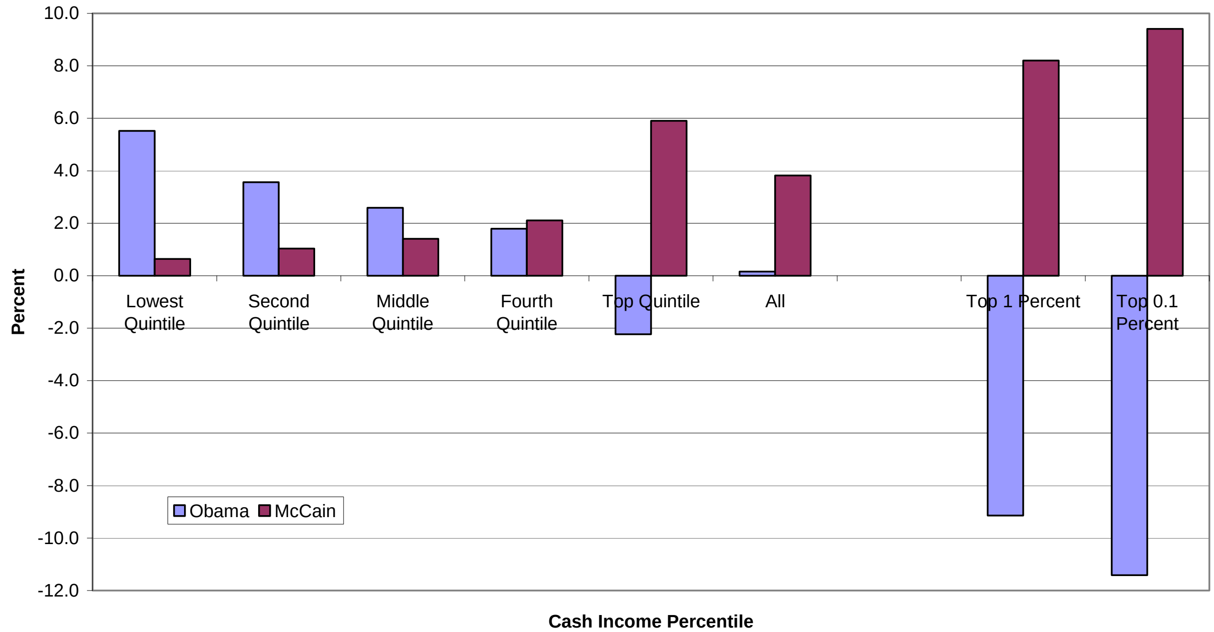
Table 12
Senator Obama's Tax Proposals of August 14, 2008: Stump Speech Version (With Payroll Surtax)
Distribution of Federal Tax Change by Cash Income Percentile, 2009

Cash Income Percentile[1]	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
Lowest Quintile	67.8	7.7	5.5	-567	-5.3	-0.7
Second Quintile	86.1	8.4	3.6	-892	-3.2	7.5
Middle Quintile	93.3	5.7	2.6	-1,118	-2.2	14.7
Fourth Quintile	86.4	12.1	1.8	-1,264	-1.4	18.4
Top Quintile	75.9	22.9	-2.2	4,600	1.7	27.9
All	81.2	10.5	0.2	-96	-0.1	21.6
Addendum						
80-90	83.3	14.8	2.0	-2,135	-1.6	21.1
90-95	85.6	13.9	1.9	-2,796	-1.5	23.0
95-99	63.2	36.7	-0.4	942	0.3	26.7
Top 1 Percent	6.6	93.4	-9.1	121,689	6.4	36.0
Top 0.1 Percent	0.9	99.1	-11.4	699,872	7.8	39.2

Source: Urban-Brookings Tax Policy Center Microsimulation Model (version 0308-6).
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.

The candidates' tax plans, as outlined by Senators Obama and McCain themselves on the campaign trail, would each radically alter the distribution of after-tax incomes (figure 3). Senator Obama's proposal would make the tax system even more progressive than it was before the 2001–06 tax cuts. Lower- and moderate-income households would receive the largest tax breaks as a percentage of income. Upper-income households would face huge tax increases. In contrast, Senator McCain's proposal would make the tax system even more regressive than the system created by the 2001–06 cuts. Households in the top 1 percent of the income distribution would receive average increases in after-tax income of more than 8 percent, in addition to their large benefits under the tax legislation already enacted this decade. Households in the middle of the income distribution would receive an additional 1.4 percent increase in after-tax income, on average. Those at the bottom would receive tax cuts averaging just 0.6 percent of income.

Figure 3.
Obama and McCain Tax Proposals as Described in their Stump Speeches
Average Percentage Change in After-Tax Income, 2009



Notes: All provisions are assumed to be fully phased in. The Obama proposal includes a payroll surtax.

C. *Economic Effects of the Expanded Policies*

Both of these variants raise economic concerns. Senator Obama's proposal would increase marginal tax rates on very high-income households. By how much is unclear since the exact policy has not been articulated. As we modeled it, the federal effective marginal tax rate on labor income would be 46 percent. In a high-tax location like New York City, where state and local taxes are about 10.5 percent of compensation, the total combined effective tax rate would be over 50 percent. Given that high earners, especially the self-employed, often have ways to make labor income look like business income, such high tax rates could spur a lot of avoidance activity, undermining fairness and economic efficiency. Holding spending fixed, the additional revenues would, however, reduce government borrowing and its negative effects.

The expanded version of Senator McCain's plan would magnify the advantages and disadvantages of the basic proposal. Expanding the scope of expensing would move the tax system in the direction of a tax on consumption, rather than income. This could encourage domestic investment in equipment and could raise wages by increasing capital per worker, but would also create new avenues for tax sheltering. The optional alternative tax system would also reduce marginal tax rates for many people who elect it. Eliminating the AMT, compared with simply patching it, would cut marginal tax rates for some people and raise them for others. The biggest drawback of this version of the proposal is that it would add enormously to the public debt. By 2018, tax revenues would be 16.3 percent of GDP, a level not seen since the early 1950s, before enactment of Medicaid, Medicare, or the national highway system. It seems clear that the promises Senator McCain makes (or implies) in his speeches could not be sustained without a radical and unprecedented downsizing of government.

IV. The candidates' health plans

Note: This is a very preliminary analysis. We plan to release a more complete analysis of the candidates' health plan based on our Health Insurance Policy Simulation Model (HIPSM) in September. This analysis uses the HIPSM database, but a simpler model of individuals' and firms' behavior. We also had to make many assumptions. We hope to have more details about the plans when we update and expand our analysis.

A. *Summary of the Proposals*

Both Senator McCain and Senator Obama have advanced major proposals intended to increase health insurance coverage, reduce health care costs, and improve health outcomes. The McCain proposal would replace the existing income tax exclusion for employer-paid insurance premiums with a refundable tax credit for everyone who obtains qualifying coverage. In contrast, the Obama plan would build on the existing tax exclusion by offering a refundable tax credit to help lower-income people without employment-based insurance pay for coverage and would cover some of the cost with a tax on firms that do not offer their employees health insurance.

The McCain Proposal. The centerpiece of Senator McCain's proposals to reform health care would replace the existing income tax exclusion for employer-sponsored health insurance (ESI) premiums with a direct, refundable tax credit of $2,500 for individuals and $5,000 for families who obtain qualifying health insurance coverage. The credit would go directly to health insurers and participants could deposit any amount in excess of premiums into personal health savings accounts (HSAs). Because it loosens the historical tie between jobs and health insurance and makes health coverage portable, the proposal could reduce job lock and improve economic efficiency. We assume that self-employment health insurance deductions are eliminated. Other parts of the proposal, which TPC has not modeled, would establish subsidized high-risk pools for individuals and families that cannot obtain coverage due to preexisting health conditions, expand HSAs, introduce a number of initiatives to reduce health care costs, and develop strategies to improve long-term care.

The plan represents an improvement on President Bush's proposal to replace the income and payroll tax exclusions with a new Standard Deduction for Health Insurance (SDHI). Like the SDHI proposal, the amount of the subsidy does not depend on the cost of the insurance purchased as long as the policy meets minimum requirements. Thus, unlike the ESI exclusion, the credit does not encourage acquisition of overly comprehensive insurance and may thus help to rein in health care costs. Like SDHI, McCain's credit is available for nongroup insurance as well as ESI, although, unlike the SDHI proposal, employment-based insurance retains an advantage because compensation paid in the form of health insurance would continue to be exempt from payroll taxes. However, unlike SDHI, which is worth most to taxpayers in high tax brackets and little or nothing to the lower-income households who are most likely to lack insurance, Senator McCain's proposed refundable tax credit would have equal value for all households with health insurance, regardless of their tax bracket.

The proposal shifts the opportunities to obtain insurance in different ways, depending on a range of factors. Workers offered insurance through their employers lose the value of the income tax exclusion but gain the credit; the combination leads to higher effective costs of insurance for some (those in the higher tax brackets or who have relatively high-cost employer-sponsored insurance) and lower costs for others (those in lower tax brackets or who have less expensive insurance). In addition, by extending a tax subsidy to nongroup coverage, everyone would gain access to lower cost insurance not tied to their jobs. Some workers, especially young and healthy ones who can find inexpensive insurance in the nongroup market, would decide that ESI was no longer their best option and would refuse their employer's offer of insurance (and expect higher wages). Some employers, finding that their average premiums increase as the healthy employees opt out, would decide to stop offering coverage. This outcome could be especially pronounced among smaller firms, which tend to face the highest premiums and the greatest risk of large premium swings if their employees' health status worsens. An aggravating factor is that employers would no longer have to offer insurance to their employees to qualify for tax-favored health insurance themselves. On the other hand, some employers—especially those who can find inexpensive health insurance—could face pressure from employees to offer coverage because the tax credit and payroll tax exemptions would make ESI affordable.

The proposal is initially very generous compared with current law. A $2,500 tax credit would be equivalent to the income tax exclusion on a $10,000 ESI premium for a taxpayer in the 25 percent tax bracket. (25 percent of $10,000 is $2,500.) A $5,000 family credit would be equivalent to a $20,000 premium. Both of these are much larger than even the most generous group health insurance premiums.

We assume, however, that, like the SDHI proposal, the McCain plan would index the tax credits based on the consumer price index, which has historically risen much more slowly than health care costs. Over time the credit would cover an ever smaller share of premiums and after-tax premiums would grow faster than health care costs. Fewer people would choose to obtain coverage and revenue losses associated with the proposal would fall.

A further complication is that the McCain plan would allow health insurers to sell across state lines. This would sound the death knell for community-rated insurance in the few states that require it, since healthy state residents could get a better deal by purchasing insurance from a different state. It would similarly threaten other state mandates to cover services such as prenatal care and childbirth. As a result, risk segmentation—in which insurers try to exclude high-cost people or charge them very high premiums—could grow quite acute, potentially causing many vulnerable policyholders to lose coverage. Senator McCain proposes to mitigate this problem by creating a subsidized high-risk pool. As we discuss below, that could either turn out to be ineffective or very expensive.

The Obama Proposal. Senator Obama would provide more targeted subsidies to low-income families who lack access to employer-sponsored insurance or public insurance and buy insurance in a new insurance exchange, penalize employers who do not offer health insurance, mandate health insurance coverage for children, require that family policies cover children up to age 25, expand the state children's health insurance program (SCHIP) and Medicaid, and provide subsidies for small employers.

Here is what we assumed about the Obama plan:

Insurance exchange. We assume that premiums equal 110 percent of the average premium faced by large firms. Individuals are guaranteed coverage in the insurance exchange and employers may purchase insurance through the exchange.

Subsidy for health insurance purchased through the insurance exchange. We assume a subsidy schedule similar to that analyzed by Gruber (2008).[25] We designed the assumed subsidy rates to meet the campaign's revenue targets for the program. Families with income above 400 percent of poverty receive no subsidy.

Premium as Percentage of Income	Income Range as Percentage of Poverty
1	0–100
3	100–150
6	150–200
9	200–250
12	250–300
16	300–350
20	350–400

In addition, as in Gruber (2008), we assume that lower-income employees with an ESI offer may use the employer's contribution to purchase subsidized insurance through the insurance exchange. People eligible for public health insurance but willing to buy coverage through the exchange may do so with the nongroup subsidy.

Employer's penalty (pay or play). We assume that employers with 10 or more employees who fail to offer health insurance to their employees would pay a tax of 6 percent of cash wages up to 80 percent of the average premium paid by firms of the given size for single coverage.

Refundable credits for small employers. We assume the credit equals 50 percent of premiums paid by firms with 9 employees or fewer and 10 percent of premiums for firms with 10 to 24 employees.

Expand public health insurance eligibility. We assume that Medicaid is available for all members of families with income at or below 100 percent of poverty and that SCHIP is extended to all children age 18 and under in families with income up to 300 percent of poverty.

Mandate all parents to cover children up to age 18. Obama's plan would require parents to obtain qualifying insurance for their children. Thus, we assume that parents with income above 300 percent of poverty must buy private health insurance to cover their children. We assume that 95 percent of uninsured children gain coverage due to the mandate and other provisions.

[25] Jonathan Gruber, "Covering the Uninsured in the U.S.", January 2008, NBER Working Paper #13758.

Auto-enrollment ESI and children up to age 25 covered in family plans. We assume that employers must enroll employees unless the worker explicitly opts out of insurance coverage. All family health insurance plans must cover dependent children up to age 25.

Senator Obama's proposal is intended to provide universal coverage by targeting subsidies to those who most need help and who are most likely to lack health insurance. However, since the proposal is voluntary for adults and spending on the subsidy is limited, the plan is destined to fall short of its goal. One key element of the plan is the penalty on employers who do not offer qualifying coverage to their employees. A high enough penalty could increase employer offer but there is a trade-off: high penalties also raise the cost of employment, which could reduce wages without expanding coverage—especially in firms where the workers do not qualify for substantial subsidies. In addition, as long as the mandate exempts small firms, employees who do not value insurance will likely gravitate to small firms (even more than they do now). To avoid these negative consequences, we assume a relatively modest payroll tax for firms that do not offer a health insurance plan.

B. *Effects of Plans on Coverage, Revenues, and Distribution of Tax Burdens*

Under our assumptions, if the plans took effect in 2009, the McCain plan would cost about $1.3 trillion over ten years and the Obama plan would cost about $1.6 trillion. (Table H1.) The pattern of spending differs dramatically between the two plans. Because Senator McCain's proposed tax credit would grow in value much more slowly than health insurance premiums (and the value of the ESI exclusion), it would reduce tax revenues by $185 billion in 2009, but only $64 billion in 2018. Senator Obama's plan would cost $86 billion in 2009, but more than twice that amount in 2018—$237 billion—as more people take up subsidized insurance and the costs of the subsidies grows because subsidies are tied directly to premiums.

Both campaigns propose measures that they believe will slow the rise of health insurance premiums, which would reduce the cost of both their new subsidies and existing public programs. We have not evaluated the effectiveness of those measures. However, if the rate of growth of premiums slowed by one percentage point per year, the cost of the direct subsidies described here would fall to $1.2 and $1.4 trillion, respectively, for the two plans (shown as the Alternative Premium in Table H1). Additional savings would accrue to the Medicare, Medicaid and other public programs.

Under our assumptions, Senator Obama's plan would reduce the number of uninsured Americans by about 18 million in 2009 and 34 million in 2018. (Table H2) Almost all children would have coverage because the law would require it, but nearly 33 million adults would still lack coverage in 2018. Senator McCain's plan would have far more modest effects, reducing the number of uninsured by just over 1 million in 2009, rising to a maximum of almost 5 million in 2013, after which the number of uninsured would creep upward because the credits grow more slowly than premiums.

Both plans are highly progressive, although Senator Obama's plan targets subsidies more toward low- and middle-income households and is thus significantly more progressive than Senator

Table H1. Health Plan Costs Relative to Baseline Costs [billions of nominal dollars]

	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	Total
Obama's Plan											
Baseline Premium	86	102	123	141	160	173	187	203	219	237	1,630
Alternative Premium	86	100	117	131	145	154	163	172	182	192	1,443
McCain's Plan											
Baseline Premium	185	175	164	153	141	129	116	101	83	64	1,311
Alternative Premium	185	174	161	149	136	123	108	90	71	49	1,246

Note Alternative premium estimates assume that premiums grow 1 percent slower than under the baseline case. The estimates do not account for savings in Medicare, Medicaid, or S-CHIP from lower health care costs.

McCain's proposal. (Table H3) Senator Obama's proposal would reduce the number of uninsured for low- to middle-income families more than Senator McCain's proposal. In the short run, however, McCain's proposal would result in a slightly larger reduction in the number of uninsured for high income families, but the pattern would reverse after a few years. Coverage under the McCain plan would lag over time because the tax credits would grow more slowly than health insurance premiums (which is not true of the ESI exclusion).

The relatively modest gain in coverage under Senator McCain's proposal masks a significant shift in the nature of health insurance coverage. Many small- and medium-sized employers would choose to drop coverage if their employees could obtain substantial tax credits for nongroup coverage. Also, the decline over time in value of the credit relative to premiums would reduce employers' incentives to offer insurance. By 2018, 21 million individuals would purchase insurance in the nongroup market (including the high-risk pool), but 20 million would have lost (or refused) coverage offered through their employer. Another 1 million would gain public coverage.

Many of those who would lose coverage have low incomes or high health care costs. More individuals with high health care costs could gain coverage in the nongroup market if the subsidies for the high-risk pool increased, but these subsidies could be quite expensive (and are not included in our estimates). In 2004, people in the top 5 percent of the distribution (spending more than $13,000 that year) incurred more than half of health expenditures—$267 billion. Of this amount, people without ESI spent $73 billion. Since many high-risk people in small or medium firms would likely lose coverage, the amount of spending covered by a very comprehensive high-risk pool could easily exceed $100 billion. Thus, a plan that used this method to prevent large losses in insurance coverage among the sick and needy could be extremely expensive—on the order of $1 trillion over ten years given projected health care costs.

In contrast, Senator Obama's proposal would lead to increases in the number of people insured both through employer-provided health insurance and through the nongroup insurance exchange. Although Obama's proposal is generous, the proposal would not produce universal coverage, as noted in Gruber (2008).[26] Although the proposal would benefit people in every income group on

[26] "This reflects the fact that many uninsured are uninterested in obtaining coverage even at very high subsidy rates." from page 57, "Covering the Uninsured in the U.S.", Jonathan Gruber, January 2008.

average, low- and middle-income people would stand to gain much more than high-income people. The incentives would work in different channels for different income groups, however. The number of uninsured with low incomes would fall substantially because they would take up nongroup health insurance or gain coverage under a public program. In contrast, the sizeable decrease in the number of uninsured among middle income people would come mainly from an increase in employer sponsorship. Some employers would purchase insurance through the exchange so that their lower-income employees could qualify for the subsidy, and take-up among highly subsidized employees should be high. Some employers would also be induced to offer insurance, or continue to offer insurance when they otherwise might drop coverage, because of the pay-or-play penalties and small-employer credits. Coverage would not decline over time under the Obama plan because we assume that the subsidy formula forces tax credits to grow with premiums (unlike the McCain plan where the credits would lag premium growth).

Senator Obama's plan would be more progressive than Senator McCain's (Table H2). If fully phased in, Obama's plan would increase average after-tax income by 21 percent for the bottom quintile in 2009. The subsidies would be worth 23 percent of income for the bottom quintile by 2013, rising to 27 percent by 2018. The subsidies would increase as a share of income because we assume that health insurance premiums would grow faster than income. Higher income people, however, would experience a small increase in taxes under the Obama plan because we assume that the pay-or-play tax is passed through to workers in the form of lower wages.

The benefits of the McCain plan would be distributed more broadly, raising after-tax income in 2009 about 9 percent for the bottom quintile, 3 percent for the middle quintile, and less than 1 percent for the top quintile. However, as health care inflation erodes the value of the tax credit, the subsidy would decline over time. By 2018, high-income households would be worse off than they would have been under current law because the credit would be worth less than the exclusion of ESI for those in the top tax brackets.

It should be emphasized that these estimates are simply illustrative since we had to assume so much about each candidate's plan. Moreover, estimates of changes in coverage depend heavily on assumptions about how health insurance coverage would respond to changes in after-tax premiums and subsidies.

Changes in plan design could significantly affect coverage and both candidates could fruitfully borrow features of the other's plan. For example, if Senator Obama eliminated or scaled back the existing ESI exclusion, more money would be available to subsidize health insurance premiums among those with modest incomes, expanding coverage without increasing the overall cost of the plan. If Senator McCain adapted something like Senator Obama's insurance exchange in his plan, the risk-segmentation in the nongroup market would substantially diminish, as would the need for a high-risk pool.

Table H2a. Baseline Number of People by Coverage Status (in millions)

Year	ESI	Nongroup	Public	Uninsured	All
2009	169.9	28.5	53.2	52.1	303.7
2010	169.5	28.7	54.3	54.0	306.4
2011	168.8	28.8	55.5	55.9	309.0
2012	168.5	29.0	56.7	57.5	311.7
2013	168.0	29.2	58.0	59.2	314.4
2014	167.7	29.3	59.2	60.8	317.0
2015	167.3	29.5	60.6	62.3	319.7
2016	167.1	29.6	61.9	63.8	322.4
2017	166.7	29.8	63.2	65.4	325.1
2018	166.7	30.0	64.4	66.8	327.8

Table H2b. Change in Number of People by Coverage Status under McCain Health Plan (in millions)

Year	ESI	Nongroup	Public	Uninsured
2009	-3.3	4.7	0.0	-1.3
2010	-7.7	9.9	0.2	-2.4
2011	-11.5	15.0	0.2	-3.6
2012	-14.3	18.5	0.3	-4.5
2013	-16.3	20.6	0.4	-4.6
2014	-17.2	21.1	0.4	-4.3
2015	-17.8	21.2	0.5	-3.9
2016	-18.7	21.3	0.6	-3.2
2017	-19.5	21.5	0.7	-2.7
2018	-20.3	21.4	0.9	-2.0

Table H2c. Change in Number of People by Coverage Status under Obama Health Plan (in millions)

Year	ESI	Nongroup	Public	Uninsured
2009	4.3	5.8	8.3	-18.4
2010	2.9	11.2	7.4	-21.4
2011	1.7	16.9	6.5	-25.0
2012	0.8	21.0	5.7	-27.5
2013	0.4	24.2	5.1	-29.6
2014	0.4	25.1	5.0	-30.5
2015	0.5	26.0	4.8	-31.4
2016	0.5	27.0	4.6	-32.2
2017	0.6	27.9	4.6	-33.1
2018	0.4	29.0	4.4	-33.9

Table H3a
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2009

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-797	8.8	-1,894	21.0
Second Quintile	-1,240	4.7	-1,392	5.3
Third Quintile	-1,559	3.4	-269	0.6
Fourth Quintile	-1,641	2.2	283	-0.4
Fifth Quintile	-1,170	0.6	281	-0.2
All	**-1,241**	2.2	**-782**	1.4
80th-90th Percentile	-1,232	1.1	282	-0.3
90th-95th Percentile	-1,203	0.8	278	-0.2
95th-99th Percentile	-1,095	0.4	275	-0.1
Top 1 percent	-664	0.1	313	0.0
Top 0.1 percent	-390	0.0	401	0.0

Table H3b
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2013

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-713	6.8	-2,449	23.4
Second Quintile	-1,018	3.4	-1,870	6.3
Third Quintile	-1,288	2.5	-357	0.7
Fourth Quintile	-1,027	1.2	395	-0.5
Fifth Quintile	-352	0.2	389	-0.2
All	**-895**	1.4	**-1,013**	1.6
80th-90th Percentile	-494	0.4	400	-0.3
90th-95th Percentile	-470	0.3	367	-0.2
95th-99th Percentile	-140	0.1	384	-0.1
Top 1 percent	845	-0.1	411	0.0
Top 0.1 percent	960	0.0	549	0.0

Table H3c
Average Federal Tax Change (including value of direct subsidies) Under Candidates' Health Proposal, Fully Phased In, 2018

Tax Unit's Cash Income	Senator McCain		Senator Obama	
	Average [$]	Percent change in after-tax income	Average [$]	Percent change in after-tax income
Lowest Quintile	-670	5.2	-3,442	26.7
Second Quintile	-830	2.3	-2,697	7.6
Third Quintile	-830	1.4	-568	0.9
Fourth Quintile	13	0.0	562	-0.6
Fifth Quintile	921	-0.4	560	-0.2
All	**-386**	0.5	**-1,436**	1.9
80th-90th Percentile	654	-0.4	551	-0.4
90th-95th Percentile	840	-0.4	550	-0.3
95th-99th Percentile	1,277	-0.4	586	-0.2
Top 1 percent	2,655	-0.2	614	0.0
Top 0.1 percent	2,840	-0.1	803	0.0

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