Congressional scorekeepers release deficit-reduction options, federal tax expenditure estimates

As Republican House and Senate leaders contemplate moving a significant tax bill in 2025 and weigh its potential cost to the US fisc, the Congressional Budget Office (CBO) this week released its latest report on options for reducing the federal deficit and the Joint Committee on Taxation (JCT) staff released its latest estimate of federal tax expenditures.

CBO's deficit-reduction options

The CBO report, released on December 12, describes a range of different tax and spending options that lawmakers may consider for reducing the federal debt over the next decade (from 2025-2034).
URL: https://www.cbo.gov/system/files/2024-12/60557-budget-options.pdf

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

Rising federal debt and deficit levels: The CBO notes that this latest report comes as the US continues to face unprecedented deficit and debt projections. The agency projected in June that the federal deficit would average $1.9 trillion per year between 2025 and 2034, or 5.4 percent of gross domestic product (GDP), compared to an average of 3.7 percent of GDP over the past 50 years. CBO also projected that federal debt held by the public would rise to 122 percent of GDP at the end of 2034, and would continue to rise thereafter, reaching 166 percent of GDP in 2054.

"To put the federal budget on a sustainable long-term path, lawmakers would need to make significant policy changes—taking actions to cause revenues to rise more than they would under current law, reducing spending for large benefit programs to amounts below those currently projected, or adopting some combination of those approaches," the agency notes. The report is intended to provide an array of policy options and their effect on the federal budget "to help inform lawmakers as they address budgetary challenges."

Individual-focused revenue options: Many of the tax-related options identified in the report would generate additional revenue for deficit reduction on the individual side of the Internal Revenue Code by modifying current-law provisions or enacting new taxes.

Among the possible modifications are:

- Increasing all tax rates on individual income by 1 percentage point (estimated 10-year deficit reduction: $1.19 trillion);

- Eliminating all itemized deductions ($3.42 trillion), limiting the tax benefits of itemized deductions to 15 percent of their total value ($1.9 trillion), or limiting that benefit to 4 percent of adjusted gross income (AGI) ($736.4 billion);
- Eliminating the SALT deduction ($1.6 trillion);
- Expanding the application of Social Security payroll taxes to include earned income over the current-law cap of $250,000 ($1.43 trillion) or by imposing the tax on 90 percent of earnings ($727.6 billion);
- Modifying the treatment of assets held at death by adopting carryover basis rules ($196.9 billion) and including accrued capital gains in the last income tax return of a decedent ($536.1 billion);
- Limiting the income and payroll tax exclusion for employer-provided health insurance to the 50th percentile of premiums (10-year deficit reduction: $965 billion);
- Imposing a 2 percent payroll tax (to be paid entirely by employees) on all earned income that would apply *in addition to* existing payroll taxes for Social Security and Medicare (estimated 10-year deficit reduction: $2.54 trillion); and
- Imposing a surtax of 1 percentage point on individual AGI greater than $20,000 for single filers/$40,000 for joint filers (10-year deficit reduction: $1.44 trillion) or 2 percentage points for AGI greater than $100,000 for single filers and $200,000 for joint filers (10-year deficit reduction: $1.05 trillion).

Business-focused options: Among the deficit-reduction options affecting business taxpayers identified in the CBO report are:

- Increasing the corporate tax rate by 1 percentage point (estimated 10-year deficit reduction: $135.7 billion);
- Taxing all foreign income of US corporations at the full statutory corporate rate ($340 billion);
- Requiring half of advertising expenses to be amortized over 10 years ($177.2 billion);
- Repealing the "last in, first out" approach to inventory identification and the "lower of cost or market" and "subnormal goods" methods of inventory valuation ($104.4 billion);
- Expanding the base of the net investment income tax to include the income of active participants in S corporations and limited partnerships ($420 billion); and
- Treating carried interests that general partners receive for performing investment management services as labor income, taxed at ordinary income tax rates and subject to the self-employment tax ($13 billion).

Value-added and environmental impact taxes: Moving beyond income taxes, the CBO report notes that lawmakers could reduce the deficit through options such as imposing a new 5 percent value-added tax that would apply to a broad base that encompasses most goods and services (estimated 10-year deficit reduction: $3 trillion) or to a narrower base that excludes certain essential goods and services (estimated 10-year deficit reduction: $2.18 trillion).

The CBO noted that lawmakers also could reduce the deficit by imposing a new tax on greenhouse gas emissions of $25 per metric ton, subject to an annual increase of 5 percent, indexed for inflation ($919 billion), the report states.

JCT's federal tax expenditure estimates

The nonpartisan Joint Committee on Taxation staff, for its part, gave lawmakers additional guidance with the release on December 11 of its estimate of federal tax expenditures for fiscal years 2024-2028.
URL: https://www.jct.gov/publications/2024/jcx-48-24/

Tax expenditures are defined under the Congressional Budget and Impoundment Control Act of 1974 as "revenue losses attributable to provisions of the federal tax laws which allow a special exclusion, exemption, or deduction from gross income or which provide a special credit, a preferential rate of tax, or a deferral of tax liability." The JCT report provides cost estimates for these provisions to "help policymakers and the public understand the ways in which government revenues are spent, and the tax and economic policy consequences that follow from the implicit or explicit choices made in fashioning legislation."

Among the more sizable expenditures identified in the report for 2024-2028 are the:

- Reduced rate of tax on the active income of controlled foreign corporations ($213.6 billion);
- Reduced rates of tax on dividends and long-term capital gains ($1.2 trillion);
- Exclusion of capital gains on sales of principal residences ($269 billion);
- Deduction for mortgage interest on owner-occupied residences ($382 billion);
- Deduction for qualified business income ($156 billion);
- Exclusion of capital gains at death ($336 billion);
- Credit for children and other dependents ($400 billion);
- Deduction for charitable contributions, other than for education and health ($345 billion);
- Subsidies for insurance purchased through health benefit exchange ($555 billion);
- Exclusion of employer contributions for health care, health insurance premiums, and long-term care insurance premiums ($1.19 trillion); and the
- Net exclusion of contributions and earnings tax-preferred retirement plans, including defined contribution plans, defined benefit plans, and sole proprietor plans ($2.31 trillion).

In addition to providing cost estimates, the report also presents distributional projections of tax return data for income classes as well as distributions of selected individual tax expenditures by income class. Further, the JCT report indicates that, a tax expenditure calculation is not the same as a revenue estimate for purposes of repealing the tax expenditure provision because of behavioral changes, interactions in the tax code, and the fact that the amount of revenue raised from repealing a provision can differ depending on timing.

— Michael DeHoff and Steven Grodnitzky
Tax Policy Group
Deloitte Tax LLP

About Deloitte

Deloitte refers to one or more of Deloitte Touche Tohmatsu Limited ("DTTL"), its global network of member firms, and their related entities (collectively, the "Deloitte organization"). DTTL (also referred to as "Deloitte Global") and each of its member firms and related entities are legally separate and independent entities, which cannot obligate or bind each other in respect of third parties. DTTL and each DTTL member firm and related entity is liable only for its own acts and omissions, and not those of each other. DTTL does not provide services to clients. Please see www.deloitte.com/about to learn more.

Deloitte provides industry-leading audit and assurance, tax and legal, consulting, financial advisory, and risk advisory services to nearly 90% of the Fortune Global 500® and thousands of private companies. Our professionals deliver measurable and lasting results that help reinforce public trust in capital markets, enable clients to transform and thrive, and lead the way toward a stronger economy, a more equitable society and a sustainable world. Building on its 175-plus year history, Deloitte spans more than 150 countries and territories. Learn how Deloitte's approximately 415,000 people worldwide make an impact that matters at www.deloitte.com.