BIPARTISAN POLICY CENTER

SAVEGO: Tax Expenditure Sequester[1]

Should Congress fail to enact the specified amount of budget savings for the upcoming fiscal year for the SAVEGO category containing non-health care mandatory spending and revenues, the OMB would be required to eliminate the shortfall by achieving an equivalent amount of budget savings compared with the relevant baseline for each non-health care mandatory spending account, and for revenue (through a reduction in tax expenditures – ***not*** an increase of marginal tax rates or payroll tax rates).

To raise the requisite amount of revenue to satisfy the sequester, for individual and corporate provisions, the Office of Management and Budget (OMB) would be directed to:

1) For **deductions**: Reduce the value of all deductions by a set percentage – ***the sequester percentage*** (for example, if an individual has $10,000 in mortgage interest and the across-the-board percentage reduction to be applied is 3%, then that person may deduct only $9,700 of his or her interest).

   From a practical standpoint, the taxpayer would multiply his or her "total itemized deductions" and "total above-the-line deductions," rather than each individual deduction, by ***(100 percent – the sequester percentage)***.

2) For **exclusions**: Reduce the value of exclusions* by the sequester percentage**.** (In the example of a 3% sequester percentage, an item that was 100% excluded would be 97% excluded).

3) For **credits**: Reduce all credits by the sequester percentage.

4) For **accelerated depreciation (or expensing)**: For tax purposes, split the asset in two, allowing ***(100 percent – the sequester percentage)*** of the asset to be depreciated per the usual accelerated method (or expensed), but subject ***the sequester percentage*** of the asset to the slower depreciation rate mandated under the alternative minimum tax.

5) For **preferential rates for capital gains and dividends**: First, for calculating the sequester, replace the alternative rates with a partial exclusion (e.g., instead of the current top long-term capital gains tax rate of 15%, 57% of long-term capital gains would be exempt from taxation and the other 43% would be taxed at ordinary income tax rates). Then reduce the excluded portion of the gain or dividend by the sequester percentage, and include that amount in ordinary income.

6) For **defined-contribution retirement plans**: Subject the sequester percentage of undistributed investment returns to the income tax.

Note: The sequester would apply after all phase-outs, but before the AMT, and to the AMT itself.

***We would recommend that the following exclusions are *not* subject to sequester**:
Benefits and allowances to armed forces personnel, and some difficult-to-measure fringe benefits, such as defined-benefit pensions and parsonage allowances. These decisions would be subject to the judgment of the Congress. Only tax expenditures would be included in the sequester; legitimate business expenses necessary to measure income (such as wages paid) would not.

[1] The SAVEGO tax expenditure sequester shares many similarities with the tax reform failsafe trigger supported by the president's Fiscal Commission, although it applies to a wider range of tax expenditures.