Tax Talk: An A-Z Guide

Part 1 of 5

Center Forward Basics
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Overview

As Congress prepares to review the 2017 tax bill, it's important staff have a resource they can turn to. Center Forward is initiating a five-part series to help our readers navigate the dynamic tax landscape. While by no means exhaustive, this Basic aims to provide an overview of common terms and phrases used in tax policy discussions. Whether you're new to the intricacies of tax legislation or a seasoned professional looking for a quick refresher, this will serve as a handy reference guide. Each definition will break down complex terminology into easy-to-understand explanations, providing context and clarity. Stay tuned as we delve into the foundational elements of tax policy, equipping you with the knowledge to engage in informed discussions and make well-rounded decisions.

Glossary

Adjusted Gross Income (AGI): A measure of income used to determine a tax filer's tax liability. AGI excludes certain types of income received (such as municipal bond interest, most Social Security income, and some alimony) and some expenses are deducted from AGI (such as Individual Retirement Account deductions, some educational expenses, and health insurance premiums for the self-employed).

Amended return: A tax return filed to correct errors reported on a previously filed return.

Appropriation: Money a state or federal legislature designates for a specific purpose.

Automatic stabilizers: Features of government tax and transfer systems that provide less fiscal stimulus when the economy expands rapidly and more fiscal stimulus when the economy slumps, without direct intervention by policymakers. The best-known automatic stabilizers are progressively graduated corporate and personal income taxes, and transfer systems such as unemployment insurance and welfare.

Audit: An examination of an individual's or organization's financial accounts and statements to ensure accuracy and compliance with tax laws.

Balanced budget: A budget in which revenues equal expenses. A balanced budget has neither a deficit nor a surplus.

Base broadening: A term applied to efforts to expand the tax base (income or other activity subject to tax), usually by

Center Forward Basics

Center Forward brings together members of Congress, not-for profits, academic experts, trade associations, corporations and unions to find common ground. Our mission: to give centrist allies the information they need to craft common sense solutions, and provide those allies the support they need to turn those ideas into results.

In order to meet our challenges we need to put aside the partisan bickering that has gridlocked Washington and come together to find common sense solutions.

For more information, please visit www.center-forward.org eliminating deductions, exclusions, and other preferences. A broader base allows more revenue to be raised without increasing tax rates, or for rates to be cut without sacrificing revenues.

Base-Erosion Anti-Abuse Tax (BEAT): The 2017 tax reforms moved the U.S. from a worldwide taxation system to a quasi-territorial system, so foreign earnings are no longer included in a company's domestic tax base. To discourage companies operating in the U.S. from avoiding tax liability by shifting profits out of the country, Congress imposed a 10% minimum tax called Base-Erosion Anti-Abuse Tax (BEAT). The BEAT rate will increase from 10% to 12.5% in 2026.

Budget baseline: The baseline is the revenue (or spending) expected under a given set of assumptions. Traditionally, Congress and the Administration used a "current law baseline" that assumes discretionary spending grows at the rate of inflation and mandatory spending and tax revenues are determined by current law, with temporary tax provisions expiring as scheduled.

Budget resolution: A non-binding congressional outline setting out total spending, revenue, and deficit targets for at least the next five years; most resolutions use a 10-year outlook. A budget resolution does not actually appropriate funds. It sets goals and establishes tax and spending priorities. It may also include budget reconciliation instructions.

Budget scoring: Estimating the budgetary effects of proposed changes in tax and expenditure policies and enacted legislation. The budget score measures the change in revenues or spending under a new policy compared to the budget baseline.

Capital gains: The difference between the sale price and the basis of capital assets minus broker fees and other costs. Most capital gains are taxable only upon sale. Long-term gains–those realized after holding the asset for a year or longer–face lower tax rates than short-term gains, which are taxed at the same rates as ordinary income. Taxpayers can deduct up to $3,000 of net losses each year against other income; taxpayers can carry over losses above that amount and subtract them from future gains.

Capital Gains Tax: A tax on the profit realized on the sale of a non-inventory asset.

Capitalization: An increase or decrease in the value of an asset arising from a tax or subsidy provision. For example, the mortgage interest deduction may increase demand for housing and push up home values. That is, part of the subsidy is capitalized into home prices.

Child Tax Credit (CTC): A tax credit per qualifying child (currently set at $2,000 through the end of 2025). The credit is partially refundable for tax filers with earnings over a set threshold. The refundable portion is limited to 15% of earnings above that threshold, up to $1,400 per child. The maximum refundable credit is indexed for inflation.

Consumer Price Index (CPI): A measure of the average level of prices, including sales and excise taxes. Specifically, the Consumer Price Index (CPI) measures the average change in price over time of a group of consumer goods and services.

Consumption tax: Taxes on goods or services. In the U.S., most consumption taxes are levied by state and local governments as retail sales taxes, although the federal government does levy some selective consumption taxes, called "excise taxes."

Corporate Alternative Minimum Tax (CAMT): The Corporate Alternative Minimum Tax (CAMT) was adopted as part of the Inflation Reduction Act and imposes a 15% minimum tax on a company's adjusted financial statement income, also known as book income, for U.S. earnings. The CAMT will raise taxes on U.S. corporations by nearly $222 billion over the next decade.

Corporate income tax: A corporation's taxable income is its total receipts minus allowable expenses, including capital depreciation.

Debt service: The amount needed to repay interest and principal on a debt over a period of time. For an individual, this might be the amount they owe on student loans or a mortgage. For the federal government, debt service is the interest paid on the national debt.

Deduction: A reduction in taxable income for certain expenses. Some deductions, such as those for contributions to an Individual Retirement Account, reduce AGI (Adjusted Gross Income). Most deductions for individual income taxpayers, such as those for home mortgage interest and state and local taxes, are only available to those who itemize deductions. Most taxpayers choose not to itemize and instead claim the standard deduction because it provides a greater tax benefit. Because tax rates increase with taxable income, each dollar of a deduction generally benefits a high-income taxpayer more than a low-income taxpayer. Deductions cannot reduce taxable income below zero.

Deficit: The difference when what the government takes in is less than what it spends during a year.

Dependent: A person who relies on the taxpayer for financial support, such as a child or elderly relative.

Depreciation: A measurement of the declining value of assets over time because of physical deterioration or obsolescence. Under income taxes, annual depreciation deductions are usually calculated under a prescribed schedule that allows the asset's cost to be fully recovered over its specified "useful life." For many assets, the depreciation schedule under the tax law allows larger deductions in early years than would be expected due to economic depreciation.

Dividends: Profits distributed by a corporation to its individual shareholders. Most dividends are taxed at the same lower tax rates that apply to capital gains.

Earmarked tax: A tax dedicated to fund a particular spending program. The most prominent earmarked taxes are the payroll taxes dedicated to fund Social Security and Medicare, and motor fuels excise taxes, which are devoted to the highway trust fund and mass transit programs.

Earned Income Tax Credit (EITC): A refundable tax credit that supplements the earnings of low-income workers. Originally enacted in 1975, its purpose is to encourage people to increase labor force participation and help low-income households escape poverty. The credit is a fixed percentage of earnings up to a maximum amount, remains constant over a range of earnings above that amount (the "plateau"), and then phases out as income rises further.

Effective tax rate (ETR): A widely used measure of tax burdens, equal to the tax paid divided by some measure of income. ETRs may be calculated with respect to a single tax, such as the individual income tax, or with respect to all taxes together (i.e., including payroll taxes, corporate income taxes, and estate taxes). The ETR may differ substantially from the economic incidence of a tax.

Entitlements: Federal programs that guarantee benefits to individuals who meet certain criteria set by law, including making contributions to those programs throughout their working lives. The largest entitlement programs are Social Security, Medicare, and Medicaid.

Estimated tax: Periodic advance payments of income tax, made quarterly, by individuals or companies whose income is not subject to withholding tax.

Exemption: An amount that taxpayers can subtract from their income for each dependent they can claim.

Federal Reserve (The Fed): The central bank of the US that controls monetary policy. The Federal Reserve System of the U.S. also referred to as the Fed, is made up of 12 Federal Reserve Banks throughout the country and headed by a Board of Governors. The Fed controls monetary policy by raising or lowering interest rates or making open-market sales or purchases of government bonds and Treasury bills.

Filing status: Tax filers fall into one of five categories, depending on their marital status and family structure. A single person without children files as a *single*; a single parent with dependent children files as a *head of household*; a married couple, with or without children, files either as *married filing joint* or *married filing separate*; and a recent widow(er) may file as a *qualifying widow(er)*, which is the same, in effect, as *married filing joint*. The standard deduction, bracket widths, and qualification criteria for certain credits and deductions vary by filing status.

Fiscal year: A government's accounting period designated by the calendar year in which it ends. For example, the federal government's 2019 fiscal year began on October 1, 2018 and ended on September 30. 2019. The fiscal year in most states ends on June 30.

Foreign-Derived Intangible Income (FDII): Foreign-Derived Intangible Income (FDII) is income from the sale of products and services related to intellectual property (IP), such as patents, trademarks, copyrights, and certain types of software. If the IP is held in the U.S., current FDII rules tax the earnings at a lower rate, incentivizing companies to keep their IP in the U.S.. Read a more in-depth overview of FDII here.

Foreign tax credit: A credit that allows U.S. residents to subtract foreign income taxes paid from the U.S. income tax due on income earned abroad.

Global Intangible Low-Taxed Income (GILTI): Global Intangible Low-Taxed Income (GILTI) is a new form of taxation on foreign earnings of U.S.-headquartered companies, adopted as part of the 2017 tax reforms to discourage companies from housing intangible assets (copyrights, patents, trademarks) in lower tax countries. In practice, GILTI functions like a minimum tax on foreign earnings. Read a more in-depth overview of GILTI here.

Gross domestic product (GDP): The total value of goods and services produced by the economy. It equals the sum of all consumption, investment, government purchases, and exports but minus the value of imports.

Gross income: The total income an individual earns before any deductions or taxes are taken out.

Health savings account: A tax-favored account for deposits made to cover current and future health care expenses paid by the individual. Like defined contribution retirement plans, contributions to HSAs and any earnings are generally deductible (or excluded from income if made by an employer). Unlike defined contribution retirement plans, withdrawals from the account are also tax-free if they are used to pay for medical expenses.

Individual income tax: A tax on the income of an individual or household. In the U.S., a minimum income level is exempt from tax, and rates are progressive. This tax is levied on the wages, salaries, investments, and other forms of income an individual or household receives.

Individual Retirement Accounts (IRAs): Individual Retirement Accounts (IRAs) are funded by individuals through their contributions or by rolling over benefits earned under an employer-sponsored plan. In traditional IRAs, contributions and earnings are tax-free, but withdrawals are taxable. In Roth IRAs, contributions are not deductible, but earnings and withdrawals are exempt from income tax.

Inflation Reduction Act: A tax and spending bill adopted in 2022 that made available tax incentives for activities that mitigate climate change and increased the IRS budget by $80 billion to enhance tax compliance and enforcement. The law also implemented a new corporate minimum tax based on financial accounting book income and levied a tax on stock buybacks.

Interest deductibility: The ability of companies to deduct interest paid or accrued in the taxable year. Under the 2017 tax reforms, companies were permitted to deduct interest up to 30% of their earnings before interest, taxes, depreciation, and amortization (EBITDA). As of 2022, the business interest deduction is limited to 30% of a company's earnings before interest and taxes (EBIT), which increases the costs for companies that borrow to finance their equipment upgrades.

Interest expense: Refers to the cost a business incurs from borrowing money. This expense can include interest payments on loans, bonds, or other debt. For tax purposes, businesses can often deduct these interest expenses from their taxable income, reducing the amount of tax they owe.

International tax: The set of tax rules and regulations that apply to individuals, businesses, and other entities that operate across international borders. This includes the taxation of income earned by foreign subsidiaries, cross-border trade, investments, and the avoidance of double taxation through treaties between countries.

Inversions: Transactions by which a company moves its headquarters abroad through a merger or acquisition with a foreign-owned company to lower its tax liability.

Itemized deductions: Particular kinds of expenses that taxpayers may use to reduce their taxable income. The most common itemized deductions are for state and local taxes, mortgage interest payments, charitable contributions, and large medical expenses. Individuals may opt to deduct these expenses or claim a standard deduction.

Low-income housing tax credit: A tax credit given to investors for constructing and rehabilitating housing for low-income families. Credits are allocated to state housing agencies based on population. The agencies select qualifying projects and authorize credits subject to statutory limits.

Mandatory R&D Amortization: An accounting requirement which requires companies to spread out the costs associated with research and development (R&D) over several years, rather than expensing them in the tax year in which they occur. This mandatory policy complicates financial planning and potentially discourages investment in innovation.

Mandatory spending: Expenditures on federal programs that are required by the statutory structure of the program, rather than by an annual appropriation. Examples are Social Security and Medicare.

Marginal tax rate: The tax liability due on an additional dollar of income. It measures the effect of the tax system on incentives to work, save, and shelter income from tax.

Non-inventory asset: A product or service that a company buys or sells but doesn't track the quantity of. Non-inventory assets are usually not important enough to track individually or aren't sold often enough to justify the cost.

Orphan Drug Tax Credit: A tax incentive provided by the U.S. government to encourage biopharmaceutical companies to develop treatments for rare diseases, often referred to as "orphan diseases." This credit allows companies to claim a 25% tax credit on qualified clinical testing expenses incurred in the development of orphan drugs, thereby reducing the overall cost and financial risk associated with bringing these vital but less commercially viable drugs to patients.

Private equity: Investments made by individuals or firms in private companies (i.e., companies not listed on public stock exchanges) with the aim of generating high returns. These investments are often made through private equity funds. Private equity involves investing in private companies to help them grow, with the goal of making a profit.

Progressivity: A measure of how tax burdens increase with income. A progressive tax claims a proportionately larger share from higher-income income than lower-income taxpayers. Conversely, a regressive tax levies a larger share of income from lower-income households than from higher-income ones. Taxes that claim the same percentage of income from all taxpayers are termed “proportional.”

Property tax: A tax based on the value of property owned by an individual, household, or business. In the U.S., most property taxes are levied by local governments.

Qualified Business Income (QBI) Deduction: Allows domestic individuals, trusts, and estates, other than corporations, with pass-through business income to deduct up to 20% of qualified business income earned in a skilled trade or business, subject to certain limitations.

R&D credit: Government incentives that allow businesses to reduce their tax liability based on the amount they spend on R&D activities. If a company spends money on developing new products, technologies, or processes, it can get a tax credit that lowers the taxes it owes, effectively rewarding investment in innovation.

Reconciliation: A process created by the Congressional Budget Act of 1974, that allows legislation to be fast-tracked for approval and bypass the Senate filibuster threshold of 60 votes. If Congress opts to go through the "reconciliation" process, the House and Senate must set spending and tax targets. In recent years, the reconciliation process has been used to enact the Tax Cuts and Jobs Act and the Inflation Reduction Act.

Regressive tax: A tax that claims a larger percentage of the income of lower-income households than of higher-income households.

Repatriation: The process by which a corporation brings back profits earned overseas to its home country. Before the 2017 tax reforms, the U.S. tax code discouraged companies from bringing back their earnings due to high taxes. Changes under tax reform have resulted in $2.5 trillion in earnings being brought back to the U.S.

Revenue: Federal government revenue includes taxes, mandatory fees, licenses, fines, and Federal Reserve earnings. Federal revenues are also known as federal government receipts.

Standard deduction: A deduction that taxpayers may claim on their tax returns instead of itemizing deductions. Typically, taxpayers with only modest deductible amounts that could be itemized choose to take the standard deduction, as it provides a greater benefit. Single filers, heads of household, and married couples filing jointly have different standard deductions.

Stimulus: An effort to increase growth in an economy during a recession by using monetary policy, fiscal policy, or both. Fiscal policy uses tax cuts and increased government spending to boost economic growth. Monetary policy can also stimulate economic growth by reducing interest rates and through federal reserve purchases of government bonds.

Stock buybacks: A stock buyback occurs when a company purchases its own stock to reduce the number of outstanding shares on the market. The Inflation Reduction Act imposed a 1% excise tax on publicly traded companies for the value of any stock it repurchases. Companies buy back stock to make investments in themselves.

Tax credit: A reduction in tax liability for specific attributes or expenses, such as having a qualifying child or incurring expenses for paid dependent care. Unlike deductions, which reduce taxable income, a tax credit reduces tax liability dollar for dollar. Nonrefundable credits may only offset positive tax liability; in contrast, if a refundable credit exceeds the taxpayer's tax liability, the taxpayer receives the excess as a refund.

Tax expenditure: A revenue loss attributable to a provision of federal tax law that allows a special exclusion, exemption, or deduction from gross income, or provides a special credit, preferential tax rate, or deferral of tax liability. Tax expenditures often result from using tax provisions instead of direct subsidies to promote selected activities.

Tax liability: The total amount of tax that an individual or business owes to the government.

Taxable income: The final income amount used to calculate tax liability. Taxable income equals adjusted gross income (AGI) less either the standard deduction or itemized deductions and, starting in 2018, the deduction for Qualified Business Income.

Withholding: The amount of an employee's income that an employer sends directly to the federal, state, or local tax authority as partial payment of the employee's tax liability.